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by Saiful Amin

The Impact of Earning Management to the Efficiency of State-Owned Corporation Banks With Good Corporate Governance (GCG) as A Moderating Variable

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Abstract
This study aims to examine the effect of earnings management on bank efficiency, the effect of GCG on bank efficiency and the influence of earning management on the level of bank efficiency that was weakened by the GCG mechanism. The population of this study were four Indonesia's state-owned corporation bank, which the sample were all of it in the 2014-2018 period. This research method used secondary data from financial statements of each bank sample. Data analysis technique used was Moderate Regression Analysis (MRA). The results of this study found that earning management had no effect on bank efficiency, GCG affected bank efficiency and GCG was able to weaken the effect of earning management on bank efficiency levels by fifty-seven point three percent. The contributions of this research were Hamid et.al. (2018) found that earning management reduced bank efficiency in five ASEAN countries in the 1989-2015 periods; this was not in line with the results of this study which found that there was no effect of earning management on the level of bank efficiency. Furthermore, the results of this study found that GCG affects the level of bank efficiency, and it was consistent with the results of Ghofur and Sukmaningrum's research (2018) but this was not in line with Soba et.al. (2016).

Keywords: *earning management, efficiency, Good Corporate Governance*

1. Introduction

According to (Watts & Zimmerman, 1986)regarding positive accounting theory directs the focus of accounting on aspects of management behavior including earnings management. Studies on earnings management had been carried out, including in the banking sector. Among the research conducted by (Dang et al., 2008), (Fakhfakh & Nasfi, 2012), and (Sari & Astuti, 2015) which aims to find factors that influence earnings management.

Earnings management practices were closely related to management's motivation to report company earnings using methods that suit their needs. According to (Sulistyanto, 2014) earnings management was considered a mirror of the opportunistic behavior of a manager by beautifying his financial statements, namely reporting earnings or performance in accordance with the interests he/she achieves. Management uses special considerations with the aim of hiding the actual performance in order to obtain benefits from the reporting. This occurs due to differences in information held by shareholders and managers, however, managers had better information related to the company or better known as asymmetric information.

In addition to the imbalance of information, managers also had a different interests with shareholders. They try to improve their performance so that they were viewed well by shareholders, it was called agency theory. Motivation was something encourages management to produce financial statements that were able to provide a positive signal to shareholders. In the banking sector, this signal can be captured through the level of efficiency that can be maintained by banks. (Sari et al., 2017) found that there was a decline in earnings management practices in the banking sector before and after the adoption of IFRS in 2008-2015. Furthermore, (Sari & Widaninggar, 2018) research found that earnings management did not contribute to the cost of funds in the banking sector as a measure of efficiency.

The level of bank efficiency was strongly encouraged to be achieved as a form of management's ability to maximize the resources owned by the bank to the revenue obtained. Measurement of bank efficiency levels regulated in Bank Indonesia Regulation Number 14/26/ PBI/2012, namely BOPO ratio, Net Interest Margin (NIM) ratio or Net Operating Margin (NOM) ratio (Peraturan Bank Indonesia Nomor 14/26/PBI/2012 Tentang

Kegiatan Usaha Dan Jaringan Kantor Berdasarkan Modal Inti Bank, 2012). (Sari & Widaninggar, 2018) found that banks in BUKU (Bank Umum Kegiatan Usaha) 4 in Indonesia had 100% efficiency levels during the 2012-2017 period, three of which were state-owned banks. According to (Ghafur et al., 2018) a low BOPO value indicates more efficient banks in managing operational costs so as to encourage the risk that banks receive less and increase earningability.

(Hamid & Et.al., 2018) find that earnings management practices negatively affect the level of bank efficiency. This means that banks in the 5 ASEAN countries in the study experienced a decrease in the level of bank efficiency in the period 1989-2015 due to an increase in earnings management, including banks in Indonesia. By the practice of bank earnings management, the input could not be optimized, and it had to produce the expected output.

One form of efforts in suppressing earnings management was the implementation of Good Corporate Governance (GCG) in companies. (Rezaei, 2012) found that the type of earnings management used could be influenced by the adoption of GCG in 167 companies in Iran for six years, from 2004 to 2009. GCG was also able to moderate the audit committee, board of commissioners, independent commissioners and shareholders in suppressing practices earnings management in the 2013-2017 period (Umi et al., 2018). Besides being able to suppress earnings management behavior, GCG was also able to improve company efficiency, namely in research conducted by (Ghafur et al., 2018) at Islamic Banks in 2012 to 2016. If earnings management practices could be suppressed by the presence of GCG, then an increase in the level of bank efficiency will be able to achieved. The purpose of this study were as follows: (1) To analyze the effect of earnings management on bank efficiency, (2) To analyze the effect of GCG on bank efficiency, (3) To analyze the effect of earnings management on the level of bank efficiency that was weakened by the existence of GCG practices as a moderating variable.

2. Literature Review and Methodology

2.1 Literature Review

The theory explaining the relationship between owners and shareholders as principal and managers as agents first appeared in 1976 by Jensen and Meckling. Principals gave authority and trust to agents to manage the company. Owners or shareholders want managers who run the company to work in accordance with what is expected by them. In addition, managers are also required to be able to generate earnings for owners and shareholders. According to Eisenhardt (1989) humans always had a desire to be selfish, had limitations in assessing the future and trying to avoid risk. Agency theory explains that managers had a desire to display good performance on their work, trying to prosper themselves and this is what makes the difference between the interests of managers and owners or shareholders. Managers had the opportunity because they had more information than the principal, for that the principal always tries reduce this information gap by implementing good corporate governance.

Managers as parties who had complete information on the company's activities and future company processes need to give a signal to shareholders in the form of financial statements. This financial statement serves to bridge the two interests between shareholders and company management. With the limitation of information that could be accessed by shareholders raises a condition known as asymmetrical information. Asymmetric information was divided into two types (Scoot, 2000): 1). Adverse selection is a condition where management does not inform the actual facts related to the condition of the company that is able to influence the decisions of investors/shareholders, 2) Moral Hazard is a condition where management takes actions that can violate contracts, ethics or norms, without being known by shareholders or parties another external.

The banking sector has a vital role for the economy of a country, in order to drive the wheels of the economy and be able to compete with similar businesses the banking sector always seeks to improve its performance from time to time. The government also applies various policies to stimulate the performance of this sector. the bank itself is a measure of management success. Organizational performance is measured by the many achievements of the objectives set. This requires an effective strategy in order to obtain the expected results. In the banking sector, the organizational goals are not merely to generate earnings for shareholders, but also to maintain economic circulation through various types of products. finance that can be utilized by the wider community. As a performance measurement tool, efficiency is the ability to produce optimal output with inputs owned by the company. Separating the allocation of inputs and outputs can indicate the cause of inefficiency of a company. In the banking sector, Bank Indonesia measures bank performance using capital ratios, asset quality, management, earnings and liquidity or what is called CAMELS.

The initial efficiency concept was introduced by Debreu and Koopmans in 1851, then further developed by Farrel in 1957 (Abidin & Endri, 2009). According to (Farrel, 1957) there are two components in the efficiency of a company that is derived from technical efficiency and allocative efficiency, then through this concept the input used can be more than one type of input. Collaboration on technical efficiency and allocative efficiency is very important, because companies must be able to optimize the output produced with available inputs and produce outputs with the right combination at a certain price level (Kumbhaker & Knox, 2000).

Measurement of the level of efficiency can be done by using measurements such as Data Envelopment Analysis¸ Stochastic Frontier Approach (SPA) and those used in Bank Indonesia Regulation Number 14/26/PBI/2012, namely BOPO Ratio, Net Interest Margin (NIM) Ratio or Net Operating Margin Ratio (NOM). In this study using the BOPO Ratio, namely Operating Expenses compared to Operating Income (BOPO) and the Ratio of Interest Income to Interest to be Paid to Depositors. BOPO ratio was used in this study because it can show the ability of banks to measure management's ability to manage operational costs to operating income, the low rate of BOPO ratio shows that banks are more efficient, this indicates the bank is able to utilize its resources optimally (Ghafur et al., 2018).

Earnings management in banks' management must pay more attention to non-financial companies because bank operations are not as transparent as non-financial companies. At the bank, how the quality of loans cannot be known by the general public and can be hidden for a long time (Sarkar & Krishnamurty, 2013). The basis of a bank's main activity is trust, ensuring the secrecy of the customer will affect the customer's trust in the bank (Budisantoso & Nuritomo, 2014). This is regulated in Act Number 7 of 1992 "all matters relating to finance and other matters of bank customers which according to the norms of the banking world must be kept confidential". This Law regulation provides limits on information held by banks, bank management has more information than other parties. In addition, banks are also protected by government regulators regarding the bank's capital adequacy ratio. According to Dang, Wen and Chun (2008), unlike managers in other industries, bank managers usually make use of loan losses from loans to influence earnings reporting. The practice of earnings manipulation can occur because management has information and authority that allows them to increase or decrease earnings to meet the goals expected by management.

Good Corporate Governance (GCG) mechanism is a corporate governance that is able to protect stakeholders and creditors from frauds that arise in the business world. The four principles of GCG are fairness, transparency, accountability and responsibility. These four principles will direct the company towards implementing clean and responsible governance.

In state-owned corporation (BUMN) Banks through BUMN Ministerial Decree Number 117/M-MBU/2002 regulates the application of good corporate governance to SOEs, where the principles that underlie management processes and mechanisms are based on legislation and business ethics. Bank Indonesia regulates the implementation of GCG through Bank Indonesia Regulation Number 8/4/PBI/2006 which is Commercial Banks must apply the principles in bank governance, namely openness, accountability, responsibility, independence and fairness (Peraturan Bank Indonesia Nomor 8/4/PBI/2006 Tentang Penerapan Good Corporate Governance Pada Bank Umum Di Indonesia, 2006). The banking sector has strict regulations compared to other sectors, namely in terms of fulfilling its role as a financial intermediary institution and meeting the minimum capital adequacy ratio criteria. This is useful to maintain the ability of banks to maintain funding sources obtained through the community.

GCG variables in this study were measured using a composite rating obtained from the results of self-assessment by banks such as the research conducted by (Anggraita, 2012) and (Nurazmi & Lukman, 2013). The composite index is assessed based on aspects of carrying out the duties and responsibilities of the commissioners, carrying out the duties and responsibilities of the directors, completeness and implementation of the committee's tasks, handling conflicts of interest, applying the bank's compliance function, applying the internal audit function, applying the external audit function, applying the risk management and control functions. internal, provision of related party funds and large funds, transparency and the bank's strategic plan. The lower the composite value the better the implementation of GCG at the bank.

Effect of Earning Management on the Bank's Efficiency Level

The positive accounting theory explains that to deal with uncertainty in the future conditions encourage the preparation of financial statements and policy makers to use the understanding, abilities, accounting knowledge and accounting policies that are most appropriate (Watts & Zimmerman, 1986). Earnings management can be defined as decision making and management reporting that is reasonable and legal which aims to achieve stable and predictable financial results (Fakhfakh & Nasfi, 2012). Banks need to allocate their funding sources to be able to maximize income generation, but if banks do not able to optimally use these funds, this will reduce bank efficiency. Based on the research of (Hamid & et.al., 2018) improvement in earnings management practices by management has reduced the level of bank efficiency in 5 ASEAN countries.

The Effect of Good Corporate Governance (GCG) on the Bank's Efficiency Level

Good Corporate Governance (GCG) mechanism ensures the implementation of corporate governance is transparent and does not occur cheating, with good GCG implementation will increase bank efficiency. Based on research conducted by (Soba et al., 2016) found that the application of GCG had a positive effect on bank efficiency during the period 2005-2015 in 10 Turkish banks listed on the Instabul Stock Exchange, while (Ghafur et al., 2018) using Sharia banks in 2012-2016 found that getting GCG implemented actually lowered the level of bank efficiency by using a BOPO ratio.

The Effect of Earnings Management on the Bank's Efficiency Level is weakened by the existence of a GCG mechanism

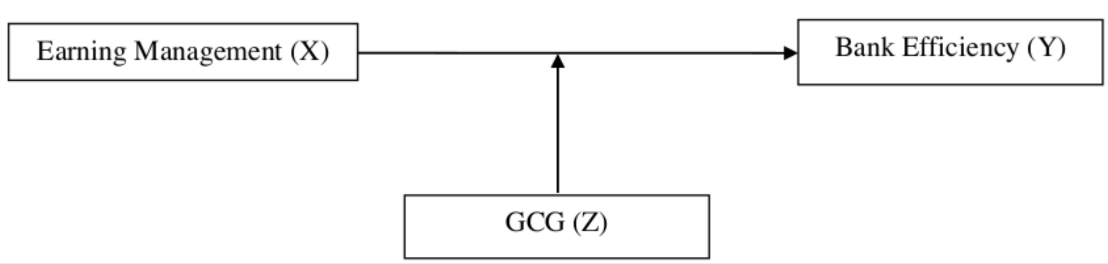
Management has the motivation to improve bank efficiency by carrying out earnings management, therefore the existence of GCG mechanism in the bank as a control within the company is expected to be able to suppress management in managing earnings.

(Anggraita, 2012) found that banks controlled by families experienced an increase in earnings management due to the weak internal corporate governance mechanism in the main family banks after the adoption of PSAK 50/55. Besides (Nurazmi & Lukman, 2013) proved that the GCG mechanism was not able to strengthen the effect of IFRS adoption on earnings management, this is because the composite value of GCG was less able to reflect corporate governance.

Conceptual framework

The conceptual framework proposed in this study is Earning Management (X) influencing the Bank's Efficiency Level (Y), and the effect of Earning Management (X) on the Bank's Efficiency Level (Y) with GCG variable (Z) as a moderating variable, so that it is implemented into Form a regression model to determine the effect of each variable.

Figure 1. Conceptual Framework



2.2 Methodology

Data Types and Sources

The type of data used in this study is secondary data. Secondary data in this study were obtained from annual financial reports that had been published by the bank. While the source of data from this study is the bank financial statements obtained from the respective bank's website and the Indonesian Banking Directory. Bank Indonesia for the period of 2014 to 2018.

Population and Sample

The population in this study is four state-owned banks in Indonesia, namely Bank Mandiri, Bank BNI, Bank BRI and Bank BTN. This study takes the population of all state-owned banks in Indonesia from 2014 to 2018 to be used as research samples. Sampling in this study is the census method (saturated sample), in which the population to be sampled in the study are four state-owned banks in Indonesia.

Operational Definitions of Variables and Research Variables

In this study involving the independent variable, the dependent variable and the moderating variable. The dependent variable (Y) used was the level of efficiency, the independent variable (Y) was earnings management, while the moderating variable used was GCG (Z). The operational definition was as follows:

1. Earning Management
   Earnings management is the intervention of bank management in submitting financial statements with a specific purpose that they want, so that the information obtained by customers or investors is misleading.
2. Bank Efficiency Level
   Efficiency is a measure of how banks optimize their resources through the use of operating expenses, to obtain optimal operating income.
3. Good Corporate Governance (GCG)
   GCG is a corporate governance mechanism that aims to control the actions of management in running the company. As a result of good GCG implementation is an increase in the reliability and transparency of reported financial statements.

Dependent Variable

The level of bank efficiency in this study was the dependent variable and was measured using the BOPO ratio (Operating Expenses compared to Operating Income). The BOPO ratio is formulated as follows:

$$BOPO = \frac{\text{Operational Expenses}}{\text{Operating Income}}$$

(Source: Peraturan Bank Indonesia Nomor 14/26/PBI/2012 Tentang Kegiatan Usaha Dan Jaringan Kantor Berdasarkan Modal Inti Bank, 2012)

Independent Variable

The independent variable used in this study is earning management, which shows that bank management attempts to increase, decrease or even the reported earnings in their financial statements. Earning management is proxied by using the discretionary accruals approach which assumes that information involving accrual accounts is inaccurate to be the basis of measurement. Earning management is calculated using The Modified Jones Model, with the following steps (Sulistyanto, 2014):

$$EM = TA_{i,t} = N_{i,t} - CFO_{i,t} \quad (1)$$

$TA_{i,t}$ was estimated with multiple regression equations, namely:

$$TA_{i,t} / AT_{i,\,t-1} = a_1(1/AT_{i,t-1}) + a_2(\Delta REV_{i,t} / AT_{i,t-1}) + a_3(PPE\ i,t) + e \quad (2)$$

$$NDA = a_1(1/AT_{i,t-1}) + a_2\{(\Delta REV_{i,t} - \Delta REC_{it})/AT_{i,t-1})\} + a_3(PPE_{it} / AT_{i,t-1}) \quad (3)$$

$$DAC_{i,t} = TA_{i,t} / AT_{i,t-1} - NDA \quad (4)$$

Notes:

DAC_{it}	: *discretionary accruals* bank i in period t
$TACC_{it}$	: *total accruals* bank i in period t
$EBXT_{it}$	: *earning before extraordinary items* bank i in period t
$CFO_{i,t}$	: *operating cash flow* bank i in period t
$TA_{i,t}$	: *total accrual* bank i period t
$AT_{i,t-1}$	: *total asset* bank i period t-1
N_{i-t}	: bank net income bank i period t
ΔREV_{it}	: change in bank income i in period t
ΔREC_{it}	: change in bank lending i in period t
PPE_{it}	: value of the fixed assets (gross) of bank i in period t
NDA	: *non-discretionary accrual*
a1, a2, a3	: regression coefficients
e	: error

Moderating Variables

In this study there is a moderating variable that is GCG. According to Ilmi, Kustono and Sayekti (2017), GCG measurements using the Corporate Governance Perception Index (CGPI) there are 38 items used in GCG disclosure where each sub-index score is given a number of 1 to be disclosed and 0 not to be disclosed.

$$CGI = \frac{A + B + C + D + E}{\text{Total Items}} x100\%$$

Source: (Ilmi et al., 2017)

Notes:

CGI	= Corporate Governance Index
A	= Shareholder rights
B	= Board of directors
C	= Board of Commissioners
D	= Audit committee and internal auditor
E	= Disclosure to investors

Data analysis technique

Descriptive Statistics Method

Descriptive statistical methods are used to analyze and present quantitative data with the aim to find out the description of the company that is the research sample. With this method can be known the average value, standard deviation, variance, maximum, and minimum (Ghozali, 2011).

Data analysis method

This research uses Moderate Regression Analysis (MRA), with the following formula:

$$\mathbf{BOPO = a + b_1\, EM + b_2\, GCG + b_3\, EM * GCG + e}$$

Testing the effects of moderation and main effects in this study using the method of hierarchical regression analysis. This method consists of two regression equations, namely the first equation containing the main effects (Model 1 and Model 2) and the second equation containing the effect main effects and moderation effects.

Main Effects:

BOPO $= a + b_1 EM + e$... Model 1
BOPO $= a + b_1 GCG + e$.. Model 2

Moderating Effects:

BOPO $= a + b_1 EM + b_2 GCG + b_3 EM*GCG + e$...................................... Model 3

Notes:

a = constant
BOPO= Bank's Efficiency Level
EM = Earning Management
GCG = Good Corporate Governance (GCG)
e = error

Testing of the effects of moderation seen from the increase/decrease in R^2. A variable is a moderating variable if an increase in R^2 between the first equation containing only the main effect with the second equation containing the main effect and moderation effect. Another test that supports hypothesis testing is the Determination Coefficient Test (R^2) namely analysis in multiple linear regression used to determine the percentage contribution of the dependent variable simultaneously to the independent variable. $R^2 = 0$ then there is not the slightest percentage of the contribution of influence given to the independent variable to the dependent variable, but if $R^2 = 1$ then the percentage of contribution given by the independent variable to the dependent variable is perfect (Sukaesih & Risa, 2014).

3. Empirical Findings and Discussion

Sample Selection Process

Sampling in this study uses the saturated sample method, where the population to be sampled in the study is the entire population. The population as well as the sample of this study were four BUMN banks in Indonesia in the 2014-2018 period, namely Bank Mandiri, Bank BNI, Bank BRI and Bank BTN.

Descriptive statistics

The results of the descriptive statistical analysis are shown in Table 4 below.

Table 4. Descriptive Statistics Results

Keterangan	N	Minimum	Maximum	Mean	Std. Deviation
BOPO	20	0.23	0.75	0.5492	0.15429
EM	20	-53.50	8.84	-24.1415	28.91198
GCG	20	0.50	0.82	0.6670	0.10433
Valid N (listwise)	20				

Based on Table 4, it can be explained as follows:

1. Overall general description is known that the average value for the level of bank efficiency using a BOPO ratio is 0.5492 or 54%. Based on Bank Indonesia regulations the allowable BOPO ratio is a maximum of 80%. The lower the BOPO percentage, the more efficient the bank is in managing operating expenses so as to generate high operating income. Banks with 23% BOPO are the National Savings Bank (BTN) in 2017 while the highest BOPO value is 75% owned by the National Savings Bank (BTN) in 2014.

2. Earnings management practices are measured using the Jones Motified method where the average value is -24.1415, which means that Bank Persero in the 2014-2018 period carried out old management practices by reducing earnings reported in its financial statements.
3. As for the GCG variable, the average value obtained is 0.6670 or 66.70%, meaning that of the 38 items that must be disclosed by the Persero, 25 items had been disclosed in the GCG report published in the 2014-2018 period.

Discussion

Earning management affects the Bank's Efficiency

Hypothesis test results indicate that earnings management has no effect on the level of bank efficiency, these results support research conducted by (Neffati et al., 2011)on 54 banks in the US that merged during 1998-2004, they found that management was motivated to do management earnings in less efficient companies. Another contradictory matter was conveyed in the research of (Hamid & Et.al., 2018) which found that earnings management behavior significantly reduced bank efficiency in the five ASEAN countries in the 1989-2015 period. The existence of earnings management practices undertaken by banks either increase, decrease or even the reported earnings on their financial statements do not affect the level of bank efficiency. Banks are still able to streamline the use of operational costs to increase their income, while the actions of managing earnings by management do not necessarily make an increase bank efficiency.

GCG affects the Bank's Efficiency

Based on the results of hypothesis testing, it is known that GCG affects the Bank's Efficiency Level in a negative direction. The CGC in this study uses the Corporate Governance Perception Index (CGPI) with 38 disclosure items. The better implementation of GCG in companies will be able to encourage transparency in the recording and reporting of corporate financial statements (Yanuar & Restuti, 2015). Through the results of this study it was found that the GCG mechanism causes efficiency to increase through the decline in the value of BOPO owned by Bank Persero. The GCG mechanism in this study uses 38 disclosure items that represent the rights of shareholders, board of directors, board of commissioners, audit committee & internal auditor and disclosure to investors. All aspects of the item are a form of long-term shareholder value realization by taking into account other stakeholders, based on legislation and ethical values (Ghafur et al., 2018). The better banks in implementing GCG will be able to drive the level of bank efficiency.

The results of this study support research conducted by (Soba et al., 2016) who found a positive influence of GCG measured by the size of the board of commissioners on bank efficiency in Turkey, as well as (Ghafur et al., 2018) who found that GCG had a positive effect on efficiency of Islamic banks in the 2012-2016 period.

Earning Management influences the Bank's Efficiency is weakened by the existence of GCG

Based on the results of hypothesis testing, there is an influence of earnings management on the level of bank efficiency weakened by the existence of GCG mechanism. It can be concluded that GCG is a moderating variable between earnings management and bank efficiency level that is able to weaken. The coefficient of determination (R2) before the existence of GCG as a mediator variable is by 48.8% whereas after GCG the mediator variable becomes 57.3%.

Conclusions

The results of this study can be concluded as follows:

1. Earnings management has no effect on the efficiency level of the Bank in the 2014-2018 period.
2. GCG affects the level of efficiency of the Persero's Bank in the 2014-2018 period.
3. Earnings management affected the efficiency of the Bank in the 2014-2018 period, which was weakened by the GCG mechanism.

The implementation of good GCG mechanism by bank management will be able to increase the level of bank efficiency, so that bank earnings will increase. Meanwhile, regulatory support from the government for the banking sector, particularly in the GCG mechanism will be able to reduce earnings management at banks so as to increase transparency and accountability so that the level of bank efficiency will be increasingly achieved. Related to the level of efficiency of the bank, researchers can then use more specific analytical methods to measure the relative efficiency of a unit, so that the causes can be identified and determine the policy implications in increasing efficiency. The analysis used for example with Data Envelopment Analysis or Stochastic Frontier Approach (SPA).

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