Corporate Governance Mechanisms_Accounting and Finance Studies

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Corporate Governance Mechanisms on Earnings management in the Indonesian Banking Sector

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ARTICLE INFO	ABSTRACT

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Research Aims: This research aims to examine the influence of corporate governance on earnings management. The corporate governance variable is proxied by independent commissioners, audit committees, and audit quality. The data in this research is secondary data originating from the financial reports of banking companies listed on the Indonesia Stock Exchange in 2019-2022.

Design/methodology/approach: The analytical techniques used to test the hypothesis in this research are descriptive statistics, classical assumption tests, and multiple linear regression analysis. The type of data used in this research is quantitative data. The sample for this research was obtained using a purposive sampling method, and a sample of 116 banking companies was obtained.

Research Findings: Test results using multiple linear regression show that the independent commissioner variable does not affect earnings management. the audit committee variable has negative impact on earnings management while audit quality variable have a significant positive effect. Test results also show that the control variable ROA has a significant negative influence on earnings management (EM). However, the leverage control variable does not influence management (EM).

Theoretical Contribution/Originality: This research contributes by providing nuanced insights into the specific impact of corporate governance components on earnings management within Indonesian banking companies. The findings offer a deeper understanding of the intricate relationships between governance mechanisms and financial practices.

Research limitation and implication: Limitations include the focus on banking companies and the specific time frame. Future research may explore diverse sectors and extend the study period. The results imply the need for policymakers and practitioners to recognize the varying impacts of different corporate governance components on earnings management for effective financial oversight.

Keywords: Good corporate governance; earnings management; banking companies

Introduction

Earnings is accounting information that can be an essential benchmark for investors in deciding to invest in a company so that management will adjust profits to attract investors [7]. The use of profit reports and information regarding profits is crucial in decision-making by various interested parties in the company. Company

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owners use profit information to evaluate the return on their investments and measure the company's performance in achieving financial goals. Conceptually, the market price of a company's shares is significantly influenced by profits. Therefore, any company whose profits always consistently increase from period to period will have a risk of experiencing a decline that is greater than the percentage increase in profits [4]. Company management checking the position of financial statements can influence individual or group decisions to invest in the company. Sometimes, they use their prerogative to manage profits through a practice known as earnings management. Earnings management can occur because there are gaps for managers in preparing financial reports, and managers can also influence important information in financial reports[3]. The ambition of company management to be able to create profit information that looks good and can be profitable in the future results in profit information becoming an object for manipulation. Actions taken by management take the form of applying different accounting policies so that they can increase or decrease company profits according to management's wishes. This management behavior is earnings management. Therefore, earnings management actions carried out by company management result in the quality of earnings decreasing and causing a reduction in the credibility of the company's financial reports.

In facing an era that tends to be free with an open economic system, more complex company management is needed. This has an impact on increasing the need for good business governance practices to ensure smooth company management. Corporate governance plays a significant role in encouraging the application of the principle of conservatism in the field of accounting (Indarti et al., 2021). Having good company management will increase a country's economic growth. This is because its implementation will strengthen the company's performance and protect it from the risk of financial difficulties (Indarti, Widiatmoko, and Pamungkas, 2020). One way that good governance can occur is because of the existence of independent commissioners. In Article 120, paragraph (2) of the PT Law Commissioner Independent is defined as a commissioner who is appointed based on the results of a GMS decision and is a party who is not affiliated with the main shareholder, member of the board of directors, or other members of the board of commissioners. Independent commissioners who have no connection to the company can make a more effective contribution to protecting shareholder interests through their supervisory function (Simangunsong, Nur, and Yuyeta 2015). In research conducted by (Meli 2023a), Independent commissioners have a negative and significant effect on earnings management.

In the Decision of the Chairman of the Supervisory Board Capital Markets and Financial Institutions Number: Kep-643/Bl/2012 explains that the audit committee is a committee formed by and responsible to the Board of Commissioners to help carry out the duties and functions of the Board of Commissioners. A good audit committee can increase the clarity and quality standards of reports presented by management, thereby reducing information gaps experienced by stakeholders (Indarti, Faisal, and Yuyetta, 2023). The audit committee must ensure that the company complies with applicable laws, carries out its operations with integrity, and maintains effective control over conflicts of interest. An audit committee was also formed to be responsible for financial reporting, risk management, and control, as well as carrying out responsibilities related to corporate governance (Hanim, Amanah, and Juwita, n.d.). Research conducted by Yopie and Erika (2021) shows that it has a negative impact on earnings management practices.

Audit quality is the description of audit results following audit standards, which is the responsibility of the auditor profession. Audit quality means describing how well the work completed by the auditor is compared to predetermined standards [16]. Quality audits will increase investors' confidence in the financial reports submitted by external auditors, and investors are expected to appreciate this step from the company to reduce information gaps and as a binding tool, resulting in more excellent supervision of management[7]. Research conducted by Wahyuwidi and Lusmeida (2020) [17] shows that audit quality has a negative impact on earnings management practices. The addition of audit quality to analyze financial reports audited by quality auditors will produce quality information. The more qualified the auditor, the more earnings management actions taken by the company are expected not to occur [2].

Literature Review

The agency concept states that agency conflicts arise because managers have the leeway to choose accounting policy methods that can benefit themselves without considering obligations to shareholders, which then results in agency costs (Widiatmoko, Indarti, and Ifada, 2023). Agency Theory arises due to the existence of a work contract based on an agreement made by the agent and principal. *Agency Theory* is a contract that is formed precisely to align the interests of the principal and agent in the case of differences in the interests to be achieved (Naufal, 2023). Opportunistic human nature in agency theory, where management has more flexibility in choosing accounting policies, is reflected in temporary differences, including in exploiting opportunities arising from differences in Financial Accounting Standards (SAK) (Widiatmoko, Indarti, and Ifada 2023). The significant sales development results in encouragement and motivation for managers to take earnings management actions by maintaining sales and profits achieved by the company (Apriadi 2022). *Earnings management* is an action carried out by management in a deliberate manner aimed at gaining personal profit or for the benefit of the organization in a process related to financial reporting. Corporate governance, commonly known as corporate governance, consists of procedures and structures that aim to improve business and accountability and realize shareholder value in the long term but also pay attention to the interests of other stakeholders (Ingriani and Nugroho 2020). Companies that have a large market capitalization value are more careful in managing profits. In contrast, companies with a lower market capitalization may be more inclined to carry out earnings management to meet market expectations or financial needs. The significant role of corporate governance in determining market capitalization and company value has found that corporate governance has a positive influence on market capitalization (Widiatmoko, Indarti, and Pamungkas 2020). Having good corporate governance is the primary key to increasing the economic efficiency of a company, which has the aim of maximizing existing resources within the company so that it can increase economic results, which have an impact on shareholder welfare and accountability for other stakeholders.

independent commissioners can play a crucial role in mitigating earnings management by providing objective oversight, enhancing transparency, monitoring management actions, aligning with regulatory standards, and promoting accountability. However, their effectiveness depends on factors such as their independence, expertise, and the overall corporate governance structure.

H1. Independent commissioners has negative effect on earnings management

The audit committee, a subgroup of the board of directors, is primarily responsible for overseeing the financial reporting process, internal controls, and the external audit function within a company. The committee's effectiveness can significantly impact the extent to which earnings management occurs. An effective audit committee can serve as a strong deterrent against earnings management by providing independent oversight, reviewing financial statements, selecting reputable external auditors, monitoring internal controls, establishing whistleblower mechanisms, ensuring compliance with regulations, and possessing the necessary expertise to evaluate financial matters critically.

H2. Audit committee has negative significant on Earnings Management

The Big 4 accounting firms (Deloitte, PricewaterhouseCoopers (PwC), Ernst & Young (EY), and KPMG) are among the largest and most prestigious audit firms globally. Their influence on earnings management can be significant due to their dominance in the audit market and the resources they bring to bear on their engagements. the Big 4 accounting firms can have a significant impact on earnings management by virtue of their reputation, resources, expertise, commitment to audit quality, market pressure, regulatory oversight, and client relationships. Their influence extends beyond individual audit engagements to shape broader norms and expectations around financial reporting integrity and transparency

H3. Audit quality has negative effect on Earnings Management

Method

This research was conducted on banking companies listed on the Indonesia Stock Exchange (BEI) for the 2019-2022 period by downloading the annual report via the website www.idx.co.id. Profit management in banking companies listed on the IDX for the 2019-2022 period is the object of this research. The variables in this research are independent commissioners, audit committees, audit quality (independent variables), and earnings management (dependent variables). The analytical techniques used to test the hypothesis in this research are descriptive statistics, classical assumption tests, and multiple linear regression analysis. The type of data used in this research is quantitative data. This quantitative data includes the annual financial reports of each banking company listed on the Indonesia Stock Exchange. The population in this study are banks listed on the Indonesia Stock Exchange from 2019-2022, which can be accessed via www.idx.co.id. Samples will be taken from the population based on the criteria that will be used, namely: Companies that publish complete annual reports during the 2019 - 2022 period, complete data available, namely the data needed to detect good corporate governance and earnings management, companies that are consistently listed on the Indonesia Stock Exchange (BEI) during the observation year, namely 2019 - 2022, Companies that have positive profits during the year of observation.

Result and Discussion

Research Result

The sampling technique was purposive sampling, and several company samples that met the criteria were obtained. Based on the criteria that have been determined, the sample that will be used in this research is 29 companies with observations for 4 years, resulting in 116 companies. To be more explicit about each sampling criterion, see the table as follows.

Table 1. Research Sample Criteria

No	Criteria	Amount
1.	Banking companies that publish complete annual reports for the 2019 – 2022 period on the Indonesian Stock Exchange	44
2.	Companies that are consistently listed on the Indonesian Stock Exchange (BEI) during the observation year, namely 2019 – 2022	(2)
3.	Companies that have positive profits during the year of observation	(13)
4.	4 Year Observation Year (2019 – 2022)	116
Total Research Data		**116**

Table 2. Descriptive statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Kom Din	116	1	7	3.01	1,423
Audit Comm	116	2	8	3.94	1,218
KA	116	0	1	0.57	0.497
ROA	116	-0.0183	0.1221	0.0175	0.0196
Lev	116	0.7249	16.0786	5.6222	2,7999
EM	116	-21.4911	8.4949	-0.1236	2.7273
Valid N (listwise)	116				

Note: Kom Din = Independent Commission, Kom Dit = Audit Committee, KA = Audit Quality, ROA = Return on Assets, Lev = Leverage, EM = Earnings management (Profit Management).

The results of descriptive statistical tests in this study show that independent commissioners are measured by comparing the company's number of independent commissioners. Independent Commissioners have a minimum score of 1. Independent commissioners have a maximum score of 7. Moreover, independent commissioners have an average of 3.01 and a standard deviation value of 1,423.

Audit committees are measured by comparing the number of audit committees with accounting or financial backgrounds with the total audit committees owned by the company. The audit committee has a minimum score of 2. The audit committee has a maximum score of 8, and the audit committee has an average of 3,94 with a standard deviation value of 1,218.

The audit quality of a company is measured by looking at the company, including the Big 4 because it can be assessed through various factors such as compliance with audit standards, accuracy of financial reports, ability to identify risks, independence, reputation, and response from clients which can influence the assessment of audit quality. They run audit quality with a minimum value of 0 or is not included in the Big 4, and the maximum value of audit quality is 1, which means it is included in the Big 4. The average value of audit quality is 0,57, and the standard deviation value is 0,497.

Profitability is measured by calculating net profit before tax divided by the company's total assets. Furthermore, the minimum value obtained is -0,0183 and the maximum profitability value is 0,1221. The average profitability value is 0,0175, with a standard deviation value of 0,0196.

Leverage is calculated by dividing the company's total debt by the company's equity, with a minimum value of 0,7249 and a maximum value of 16,0786. Moreover, it has an average leverage value of 5,6222 and a standard deviation value of 2,7999.

Earnings management is measured by calculating net profit before tax divided by the company's operating cash flow. Moreover, from the table above, the minimum profit management value is -21,4911 and the maximum value is 8,4949. Earnings management has an average value of -0,1236 with a standard deviation value of 2,7273.

Table 3. T test

	coefficient	t	p-value
Kom Din	,200	,791	0.431
KomDIt	-.322	-1,177	0.042**
KA	,719	1,178	0.001***
ROA	12,047	,854	0.005***
Lev	,098	,963	0.338

Note: Kom Din = Independent Commission, Kom Dit = Audit Committee, KA = Audit Quality, ROA = Return on Assets, Lev = Leverage, EM = Earnings management (Profit Management).

Discussion

Based on the results of data testing, the results showed that independent commissioners (Kom Din) had no influence on earnings management in banking companies listed on the Indonesia Stock Exchange (BEI) in 2019 - 2022, which made (H1) not supported. This means that the more independent commissioners in a company must maintain earnings management practices that can benefit the company and its stakeholders. This is contrary to agency theory, which emphasizes the importance of a board of independent commissioners in supervising managers to prevent deviations committed by managers for their interests (Meli 2023).

The absence of the effect of independent commissioners on earnings management can be caused by ndependent commissioners, while providing oversight and guidance, may have limited authority to enforce changes or challenge management decisions directly. Their influence on management practices can be constrained by the power dynamics within the boardroom and the broader corporate governance structure. Independent commissioners may lack the technical expertise or industry-specific knowledge necessary to thoroughly understand and evaluate complex financial transactions or accounting practices. Without a deep understanding of the company's operations and financial reporting processes, they may struggle to identify subtle forms of earnings management.

Management typically has greater access to information compared to independent commissioners, which can create information asymmetry within the boardroom. This imbalance may hinder independent commissioners' ability to detect earnings management effectively, as they rely on information provided by management and may not have access to all relevant data.

Based on the results of data testing, the results obtained were that the audit committee (Kom Dit) significantly influenced earnings management (EM) in banking companies listed on the Indonesia Stock Exchange (BEI) in 2019 – 2022, which made (H2) accepted. This means that an Audit Committee in the company has a vital role in management actions in earnings management. The results of this test are supported by previous research conducted by (Yopie and Erika 2021), which shows that audit committee results have a negative impact on earnings management practices. This statement is also supported by research by (Sinurat and Sudjiman (2023) that the audit committee significantly negatively influences earnings management.

Based on the results of data testing, the results obtained show that audit quality (KA) significantly influences earnings management (EM) in banking companies listed on the Indonesia Stock Exchange (BEI) in 2019 - 2022, which makes (H3) not supported. The results of this test are supported by previous research conducted by (Susanty, 2022), which shows that audit quality has a positive impact on earnings management practices. Big 4 firms are expected to uphold high audit standards and independence, various factors such as the complexity of clients, resource constraints, client retention pressures, fee dependency, familiarity bias, internal performance pressures, and regulatory scrutiny could contribute to situations where their involvement coincides with increased earnings management. Addressing these challenges requires a commitment to maintaining audit quality, fostering auditor independence, and promoting a culture of ethical behavior within audit firms.

Conclusion

Based on the research results obtained through statistical testing and discussions described in the previous point, the independent commissioner variable has been proven not to affect the dependent variable of earnings management. Meanwhile, the audit committee and audit quality variables were proven to have a significant negative effect on the dependent variable, earnings management.

Limitations and Suggestions

This research has several limitations, and further research is recommended to improve these limitations. This research only focuses on one sector of companies listed on the Indonesia Stock Exchange: the banking company sector. Therefore, the results of this research only cover some existing sectors apart from the banking sector, so it is hoped that future researchers can expand the scope by adding other sectors or taking samples from all companies to generalize the research results. Based on the results of the research and discussion carried out in this research, several suggestions can be put forward for this research, namely that in future research, it can add other research variables that can influence earnings management and replace other index samples on the Indonesia Stock Exchange (BEI) with companies. Banking sector or others.

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