The Effect of Good Corporate Governance on Earnings Management

(Empirical Study on Technology Companies Listed on the Indonesia Stock Exchange in the years period 2020-2022)

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ABSTRACT

The purpose of this study was to examine the effect of independent board of commissioners, managerial ownership, institutional ownership, the audit committee on earnings management. The practice of earnings management is one of the primary factors causing financial statements to no longer reflect the fundamental value of the company. The population of this study is technology companies listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022, totaling 22 companies. As for the sampling technique, this study uses nonprobability sampling, specifically purposive sampling. The data was analyzed using descriptive statistics analysis, normality test, classical assumption test, and multiple linear regression analysis. The results showed that The variable of managerial ownership shows a non-significant influence on earnings management. The variable of institutional ownership also shows a non-significant influence on earnings management. The independent board of commissioners variable indicates a non-significant influence on earnings management. Meanwhile, the audit committee variable shows a significant influence on earnings management.

Keywords: Good Corporate Governance, Earning Management, Technology Companies

Introduction

The company was established with the aim of obtaining profit, which is also the goal of investors when investing in a company's shares. One of the common sectors chosen by many investors is the technology industry because of its high growth. Choosing a technology company is considered good for research because this sector is widely sought after by investors. Technology companies offer high growth potential, stable cash flows, and attractive valuations, making it a highly favored sector by investors. In 2021, this sector recorded the highest increase in the composite stock price index (IHSG). Some famous technology companies often chosen by investors include Apple Inc. (AAPL), Microsoft Corporation (MSFT), Amazon.com Inc. (AMZN), Alphabet Inc. (GOOGL), and Facebook, Inc. (FB).

Investors tend to focus on the profit or the company's ability to provide dividends, making them pay more attention to this sector. This makes management tend to pay more attention to profits, especially managers whose performance is measured based on this information, which in turn encourages the emergence of earnings management behavior.

Earnings management refers to the manipulation of timing, income, expenses, profits, and losses to smooth out profit fluctuations. In this regard, managers can exert discretion over financial reporting, which can take the form of earnings management if conducted within the framework of applicable accounting standards. This presents earnings tailored to management's objectives through the selection of accounting policies or through accrual management. The practice of earnings management is one of the primary factors causing financial statements to no longer reflect the fundamental value of the company.

The goal of management is to maximize shareholder investor prosperity. However, in reality, managers often have other objectives that may conflict with this primary goal. One reason for this is the presence of conflicts of interest between managers and shareholders or between the company's owners (principals) and its management (agents). Agency theory states that an agency relationship arises when one or more principals hire another person as an agent to provide a service and then delegate decision-making authority to that agent. This results in asymmetric information about the company's condition. Information asymmetry refers to a situation where there is an imbalance in the acquisition of information between management as information providers and shareholders and other users of financial statements.

The practice of earnings management in technology companies in recent years, amidst various efforts by government and private companies to implement good corporate governance, certainly poses its own challenges. In 2004, PT Indosat Tbk was involved in a case of financial statement manipulation, engaging in earnings management that intentionally portrayed the company as experiencing a decrease in profit to avoid tax payments through illegal means (tax evasion). The management of PT Indosat Tbk was suspected of engaging in financial engineering in the company's derivative transactions, making its financial statements appear as if they had experienced a profit decline. These transactions resulted in the loss of potential tax revenue, which harmed the country by at least IDR 323 billion.

PT Tiphone Mobile Indonesia Tbk is suspected of manipulating profits from voucher sales. Based on financial performance data for the first quarter of 2015 on the Indonesia Stock Exchange, voucher revenue contributed Rp 2.41 trillion to Tiphone's total net revenue of Rp 4.05 trillion. Meanwhile, the cost of sales for voucher business amounted to Rp 2.27 trillion, resulting in a gross profit of Rp 136.4 billion. This reflects a gross profit margin of 5.66%. When compared to the gross profit margin of voucher sales for PT Global Teleshop Tbk (GLOB) and PT Erajaya Swasembada Tbk (ERAA) at 2.6% each, it's noteworthy. However, both Global and Erajaya, through their subsidiaries, are also registered as distributors of vouchers for PT Telekomunikasi Selular (Telkomsel), just like Tiphone.

PT Envy Technologies Indonesia Tbk (ENVY) is suspected of manipulating its annual financial statements (LKT) for the year 2019 because ENVY only recorded revenue from the sale of goods amounting to Rp 2.15 billion and information technology security services amounting to Rp 400 million. ENVY did not record any revenue from information and telecommunication systems integration. However, in the first quarter of 2019, these items recorded revenues of Rp 21 billion and Rp 20.43 billion, respectively.

Good corporate governance is a system of control and regulation within a company reflected in the mechanisms governing the relationships among various parties managing the company, as well as in the values embedded in those management mechanisms. The implementation of good corporate governance can minimize any deviations within a company. This research focuses on several oversight mechanisms that are believed to reduce the occurrence of earnings management practices, namely independent board of commissioners, audit committees, as well as managerial ownership and institutional ownership.

Independent Board of Commissioners are members of the board of commissioners who do not have financial, managerial, shareholding, or family relationships with other members of the board of commissioners, directors, controlling shareholders, or other relationships that may affect their ability to act independently. They are tasked with overseeing the financial reporting process to ensure the production of high-quality financial reports. Joyce's (2019) research analyzed the influence of independent commissioners on earnings management, proving that independent commissioners do have an impact on earnings management. In contrast, Fauziyyah's (2022) study showed that the board of commissioners does not influence earnings management.

Managerial ownership refers to the ownership of company shares by management. With managerial ownership in a company, managers act like other shareholders by ensuring contracts run efficiently and financial reports are fairly presented, disclosing the true condition of the company. This is supported by Joyce (2019), who stated that managerial ownership has an influence on earnings management, meaning that the extent of managerial ownership can minimize the occurrence of earnings management. However, Ni Putu Yulya (2021) failed to prove the influence of managerial ownership on earnings management.

Institutional ownership refers to the ownership of shares by institutions or companies, measured by the percentage of total shares held by institutions in a company. The presence of institutional share ownership in a company increases oversight of the company's performance because investors act as sophisticated investors who have more ability and opportunity to monitor management. According to the research conducted by Emy (2019), institutional ownership influences earnings management. However, Reysvana (2019) failed to prove the influence of institutional ownership on earnings management.

The audit committee is a committee formed by and accountable to the board of commissioners to assist in carrying out the tasks and functions of the board of commissioners effectively. Research conducted by Shania (2020) shows that the audit committee significantly influences earnings management. However, research conducted by Diana (2021) indicates that the audit committee does not have a significant influence on earnings management. Based on the previous research results, there are still varied and inconsistent findings. Further research is needed to explain this inconsistency. The inconsistency of previous research results warrants a reexamination of the influence of the four independent variables. This study expands the scope to include technology companies listed on the Indonesia Stock Exchange (IDX) as there is still limited research using technology companies listed on the IDX as research objects.

Literature Review

Agency Theory

Agency theory is a contract between a manager (agent) and an owner (principal). Each individual is motivated by personal interests, leading to conflicts of interest between managers and owners. With differences in interests and efforts to maximize expected utility among the parties, the result is asymmetric conflict. The interests between principals and agents create a situation where information is presented inaccurately or deceitfully to the principals.

Earnings Management

Earnings management is a process of manipulating earnings according to the desires of certain parties, particularly by management. Managers utilize their creativity to prepare financial reports to influence stakeholders' actions.

Managerial Ownership

Managerial ownership is the proportion of company management shareholders actively involved in company decisions. From the perspective of accounting theory, earnings management is greatly influenced by the motivation of company managers. Different motivations will result in different levels of earnings management, such as between managers who are also shareholders and managers who are not shareholders. The interests of managers and external shareholders can be aligned if managerial share ownership is increased, so managers will not engage in earnings management for their own interests.

Institutional Ownership

Institutional ownership is the percentage of shares held by institutional investors at the end of the year. Share ownership, such as institutional ownership, holds significant meaning in monitoring management. The presence of institutional ownership, such as insurance companies, banks, investment firms, and other institutions, will promote increased and more optimal oversight.

The Audit Committee

The audit committee is a group of board members of client companies responsible for assisting auditors in maintaining their independence from management. The audit committee plays a vital role in ensuring the implementation of effective corporate governance mechanisms. Its duties include assisting the board of commissioners in monitoring the financial reporting process by management to enhance the credibility of financial reports.

Independent Board of Commissioners

Independent Board of Commissioners is the ratio of all independent commissioners of a company to the total number of commissioners. Independent commissioners are board members who come from outside the securities company and meet the requirements of independent commissioners in the financial services regulations. Independent commissioners have the primary responsibility to promote the implementation of Good Corporate Governance principles.

The impact of the relationship between Managerial Ownership on Earnings Management

Ownership of shares by management is believed to effectively prompt managers to present financial conditions that reflect reality. In agency theory, earnings management practices can be minimized by aligning the interests between owners and management through increasing managerial ownership of company shares.

Fauziyyah Ramadhani Lindra, et al. (2022) showed that managerial ownership has a negative influence on earnings management, consistent with the research conducted by Rahmadinah (2022). Joyce Lim and Syukrina E Janrosl (2019) stated that managerial ownership is one mechanism that can limit opportunistic behavior by managers in the form of earnings management. Based on the explanation above, the hypothesis can be formulated as follows:

H2: Managerial ownership has a significant influence on earnings management.

The impact of the relationship between Institutional Ownership on Earnings Management

"Institutional ownership typically holds a larger number of shares than individual investors. Institutional investors are more likely to provide more accurate opinions regarding the positive and negative impacts of managerial actions in earnings management because institutional investors are more experienced and professional in analyzing information. Agency theory explains that institutional ownership plays a crucial role in minimizing agency conflicts that occur between managers and shareholders. The presence of institutional ownership in a company will encourage an increase in supervision of management performance.

Fauziyyah Ramadhani Lindra (2019) and Rahmadinah (2022) explained that institutional ownership has a positive effect on earnings management. Based on this description, the proposed hypothesis is:

H3: Institutional ownership has a significant influence on earnings management.

The impact of the relationship Audit Committees on Earnings Management.

The audit committee is an organ that assists the board of commissioners in supervising to enhance effectiveness in creating transparency and financial reporting, compliance with regulations, and internal control oversight within the company. According to agency theory, managers hold high levels of mandate and responsibility. Therefore, it is necessary to have authorized parties responsible for supervising the financial reporting process and observing internal control systems, namely the audit committee.

The research findings of Paulinus Chizoba (2015), Joyce Lim and Viola Syukrina E Janrosl (2019), and Shania Agustin (2020) indicate that the audit committee influences earnings management. Based on this description, the hypothesis in this study is:

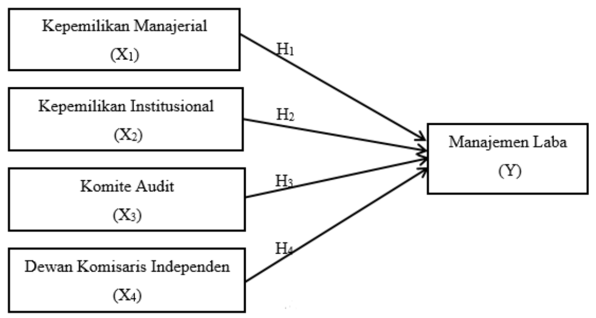
H4: The audit committee has a significant influence on earnings management.

The impact of the relationship between Commissioners on Earnings Management

The board of commissioners is established as the company's organization tasked with overseeing the policies of the board of directors in running and advising the directors in managing the company's affairs. Agency theory is a concept that explains the contractual relationship between principals and agents, while independent commissioners are board members not affiliated with management. Ni Putu Yulya Pratista Sari, et al. (2021) and Rahmadinah (2022) stated that independent commissioners have a significant negative influence on earnings management. Supported by the research of Joyce Lim and Viola Syukrina E Janrosl (2017), which stated that the size of the board of commissioners has a significant influence on earnings management. Based on the explanation above, the hypothesis can be formulated as follows:

H1: Independent commissioners have a significant influence on earnings management.

Theoretical Framework of Thinking



Source: Secondary Processed Data

Method

In this study, the type of research to be used is quantitative research with a comparative approach. Quantitative research is conducted by testing specific theories by examining the relationships between variables. This research is conducted to assess the level of earnings by testing the level of Good Corporate Governance of technology companies listed on the Indonesia Stock Exchange (IDX) during the period 2020-2022.

The population of this study is technology companies listed on the Indonesia Stock Exchange (IDX) from 2020 to 2022, totaling 22 companies. As for the sampling technique, this study uses nonprobability sampling, specifically purposive sampling, where the sample is determined using certain criteria according to the needs of the research.

Keterangan Perusahaan	Jumlah
Perusahan teknologi yang terdaftar di Bursa Efek Indonesia periode 2020-2022	34
Perusahaan sektor teknologi yang tidak terdaftar berturut-turut dari tahun 2020-2022 di Bursa Efek Indonesia.	(12)
Perusahaan yang tidak mempublikasikan laporan keuangan periode tahun 2020-2022	(2)
Perusahaan yang tidak memiliki seluruh data terkait dengan variabel dalam periode 2020-2022	(4)
Perusahaan yang terpilih menjadi sampel	16
Total sampel (n x periode penelitian) (14 x 3 tahun)	48

Source: Secondary data processed 2023

Dependent Variable

The dependent variable is management income, calculated using the modified Jones model. Measurement is done using the formula:

$$\text{DAit} = \frac{TAit}{Ait-1} - NDAit$$

Independent Variable

1. Managerial Ownership

$$\frac{\text{The Total Shares of Managerial Parties}}{\text{Total Outstanding Shares}}$$

2. Institutional Ownership

$$\frac{\text{Total of Institutional Shares}}{\text{Total Outstanding Shares}}$$

3. The Audit Committee

The audit committee uses the measurement of the total number of audit committee members in a company.

4. Independent Board of Commissioners

$$\frac{\text{Independent Board of Commissioners Members}}{\text{Total Board of Commissioners}}$$

Descriptive Statistics Analysis

Descriptive statistics is the process of transforming research data into tabulations for easy understanding and interpretation. Tabulations present a summary, arrangement, or organization of data in numeric tables and graphs. Data analysis method will be conducted with the assistance of the computer application program SPSS.

Normality Test

The normality test aims to determine whether the dependent and independent variables have a normal distribution in the regression model. This test is used as an initial step in data analysis methods.

Classical Assumption Test

To determine whether the regression model truly demonstrates a significant and representative relationship, the model must satisfy classical assumptions. The classical assumption tests conducted are multicollinearity, autocorrelation, and heteroskedasticity tests.

Multiple Linear Regression

The purpose of regression analysis is to determine how the independent variables influence the dependent variable. The model developed in the research is as follows:

$$DA = a + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 +$$

Result and Discussion

Normality Test

According to Imam Ghozali, the Normality Test aims to test whether in a regression model, the disturbance or residual variables have a normal distribution.

One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		48
Normal Parameters[a,b]	Mean	,0000000
	Std. Deviation	1,94012792
Most Extreme Differences	Absolute	,376
	Positive	,376
	Negative	-,227
Test Statistic		,376
Asymp. Sig. (2-tailed)		,000[c]

From the Kolmogorov-Smirnov test results above, a value of Asymp. Sig. (2-tailed) of 0.000 is obtained. This result can be concluded that the residual data in this regression model is not normally distributed because the Asymp. Sig. (2-tailed) value is below 0.05. To normalize the data, it is necessary to perform treatment by removing outlier data.

One-Sample Kolmogorov-Smirnov Test

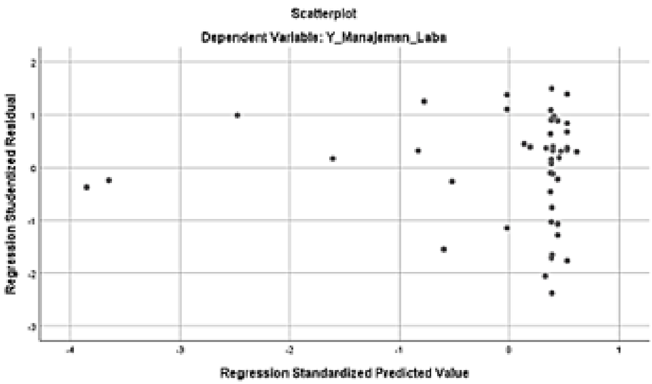
			Unstandardized Residual
N			46
Normal Parameters[a,b]	Mean		,0000000
	Std. Deviation		,41140213
Most Extreme Differences	Absolute		,142
	Positive		,072
	Negative		-,142
Test Statistic			,142
Asymp. Sig. (2-tailed)			,021[c]
Monte Carlo Sig. (2-tailed)	Sig.		,283[d]
	99% Confidence Interval	Lower Bound	,272
		Upper Bound	,295

From the Kolmogorov-Smirnov test results above, a Monte Carlo Asymp. Sig. (2-tailed) value of 0.283 is obtained. This result can be concluded that the residual data in this regression model is normally distributed because the Asymp. Sig. (2-tailed) value is above 0.05

Classical Assumption Tests

a. Heteroskedasticity Test

Heteroscedasticity test aims to examine whether there is unequal variance of residuals from one observation to another in the regression model. If the variance of residuals remains constant from one observation to another, it is called homoscedasticity, and if it differs, it is called heteroscedasticity.



Based on the above figure, it shows that the tested variable does not exhibit heteroscedasticity because there is no clear pattern and the points are scattered around the 0 on the Y-axis, indicating no heteroscedasticity

b. Multicollinearity Test

The multicollinearity test aims to determine whether there is correlation between independent variables in the regression model. The commonly used cutoff value to indicate multicollinearity is a tolerance value of ≤ 0.10 or a VIF value of ≥ 10.

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.	Collinearity Statistics Tolerance	Collinearity Statistics V
1	(Constant)	,809	,597		1,355	,203		
	SQRT_X1	,064	,292	,111	,220	,830	,299	3,3
	SQRT_X2	,142	,494	,145	,288	,778	,302	3,3
	SQRT_X4	-,776	,570	-,382	-1,362	,200	,974	1,0

From the table of multicollinearity test results, it can be seen that the tolerance values for managerial ownership (X1), institutional ownership (X2), audit committee (X3), and independent committee (X4) and the inflation factor show that the VIF and tolerance values for each variable do not exceed 10%. This means that there is no multicollinearity.

b. Autocorrelation Test

Autocorrelation is the relationship between the residual of one observation with the residual of another observation. To determine whether autocorrelation exists, the Durbin-Watson Test method is used.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	,710[a]	,505	,455	,37577	1,973

a. Predictors: (Constant), LAG_X4, LAG_X3, LAG_X2, LAG_X1

b. Dependent Variable: LAG_Y

The decision for Autocorrelation is favorable if there is no autocorrelation. In the Durbin-Watson table, it can be said that there is no positive or negative autocorrelation if du ≤ d ≤ 4-du. Based on the Durbin-Watson table, 1,7201 < 1,973 < 2,2799 the null hypothesis is accepted, assuming there is no positive or negative autocorrelation.

Multiple Linear Regression Analysis

Based on the multiple linear regression analysis using SPSS, the output obtained is as follows:

Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-1,364	,674		-2,024	,050
	X1_Kepemilikan_Manajerial	-,190	,181	-2,099	-1,053	,298
	X2_Kepemilikan_Institusional	,005	,006	1,508	,756	,454
	X3_Komite_Audit	,366	,177	,278	2,071	,045
	X4_Komisaris_Independen	,270	,657	,056	,411	,683

If applied in the regression formula, it would be:

$$y = a + b1x1 + b2x2 + b3x3 + b4x4 + e$$

$$y = -1{,}364 - 0{,}190X1 + 0{,}005x2 + 0{,}366X3 + 0{,}270X4 + e$$

The equation of the regression line obtained, then the regression model can be interpreted as follows:

a. The constant of -1.364 means that if managerial ownership (X1), institutional ownership (X2), Audit Committee (X3), and Independent Commissioner (X4) are all 0, then earnings management (Y) is -1.364.
b. The regression coefficient for the variable managerial ownership (X1) is -0.190, meaning that if the values of other independent variables remain constant and managerial ownership increases by 1 unit, earnings management (Y) decreases by 0.190.
c. The regression coefficient for the variable institutional ownership (X2) is 0.005, meaning that if the values of other independent variables remain constant and institutional ownership increases by 1 unit, earnings management (Y) increases by 0.005
d. The regression coefficient for the variable Audit Committee (X3) is 0.366, meaning that if the values of other independent variables remain constant and the Audit Committee increases by 1 unit, earnings management (Y) increases by 0.366
e. The regression coefficient for the variable Independent Commissioner (X4) is 0.270, meaning that if the values of other independent variables remain constant and

Independent Commissioner increases by 1 unit, earnings management (Y) increases by 0.270

Hypothesis Test

T-Test (Partial)

The effect of managerial ownership (X1) on earnings management (Y)

Based on the regression table above, the calculated t-value is -1.053 and t-table dk = n - 2 (46 - 2 = 44) is 2.013. Since the calculated t-value is less than t-table (-1.053 < 2.013) with a significance level of 0.298 > 0.05 (5%), it can be concluded that managerial ownership does not have a significant effect on earnings management.

The effect of institutional ownership (X2) on earnings management (Y)

Based on the regression table above, the calculated t-value is 0.756 and t-table dk = n - 2 (46 - 2 = 44) is 2.013. Since the calculated t-value is less than t-table (0.756 < 2.013) with a significance level of 0.454 > 0.05 (5%), it can be concluded that institutional ownership does not have a significant effect on earnings management.

The effect of audit committee (X3) on earnings management (Y)

Based on the regression table above, the calculated t-value is 2.071 and t-table dk = n - 2 (46 - 2 = 44) is 2.013. Since the calculated t-value is greater than t-table (2.071 > 2.013) with a significance level of 0.045 < 0.05 (5%), it can be concluded that the audit committee has a significant effect on earnings management.

The effect of independent commissioners (X4) on earnings management (Y)

Based on the regression table above, the calculated t-value is 0.411 and t-table dk = n - 2 (46 - 2 = 44) is 2.013. Since the calculated t-value > t-table (0.411 < 2.013) with a significance level of 0.683 > 0.05 (5%), it can be concluded that the independent committee does not have a significant effect on earnings management

Simultan Test (F-Test)

The F-statistic test (Simultaneous Test) is used to test the simultaneous influence of independent variables on the dependent variable. This F-test can indicate whether all independent variables collectively or simultaneously influence the dependent variable.

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4,898	4	1,224	6,591	,000[b]
	Residual	7,616	41	,186		
	Total	12,514	45			

Based on the table above, it is obtained F-value = 6,591 meanwhile, the value F-table (dk = n - k - 1 = 46-4-1=41) is 2,600 with a significance level of 0,000 < 0,05 (5%), F-value > F-table (6,591 > 2,600) thus, simultaneously, managerial ownership, institutional ownership, audit committee, and independent committee influence earnings management.

Coefficient of Determination (R^2)

The coefficient of determination (Adjusted R-Square) test essentially measures how well the model can explain the variation in the dependent variable. A small Adjusted R-Square value indicates that the ability of independent variables to explain the variation in the dependent variable is very limited. A value close to one indicates that the independent variables provide almost all the information needed to predict the variation in the dependent variable. The R^2 value in this study can be seen in the following table:

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	,626[a]	,391	,332	,43100

a. Predictors: (Constant), X4_Komisaris_Independen, X1_Kepemilikan_Manajerial, X3_Komite_Audit, X2_Kepemilikan_Institusional

Based on the table, the Adjusted R-square value obtained is 0.332. Thus, variables X1, X2, X3, and X4 collectively influence variable Y by 33.2%, while the remaining 66.8% is influenced by other variables not examined in this study

Conclusion

This research aims to obtain empirical evidence on the influence of managerial ownership, institutional ownership, audit committee, and independent board of commissioners on earnings management. The variable of managerial ownership shows a non-significant influence on earnings management. The variable of institutional ownership also shows a non-significant influence on earnings management. The independent board of commissioners variable indicates a non-significant influence on earnings management. Meanwhile, the audit committee variable shows a significant influence on earnings management.

Limitations

This research has not reached a perfect conclusive result yet. There are still many limitations in this research. The variables in this research are still limited. This study is only confined to companies in the technology sector. The research period is limited to only 3 years, which is insufficient to provide a specific and comprehensive explanation.

Suggestions

The researcher acknowledges that this study still has many shortcomings, thus providing suggestions or recommendations for future research based on the findings presented. For practitioners, it is hoped that they will take the topic of earnings management more seriously by implementing good corporate governance practices in the future. For organizations, it is hoped that in future recruitment processes and management decisions, professionals will be appointed and placed according to their expertise and field of specialization. Hopefully, the result of this research can serve as additional information on the topic of earnings management and its influencing variables. For future research, it is recommended to include additional variables, extend the time interval, and broaden the scope of objects to measure earnings management actions in companies more specifically and comprehensively.

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