Public Sector Accountants and Quantum Leap: How Far We Can Survive in Industrial Revolution 4.0?
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The good corporate governance mechanism and earnings management: Evidence from Indonesian and Malaysian manufacturing companies

W. Wahyudi, E. Setiany & W. Utami
Universitas Mercu Buana, Jakarta, Indonesia

ABSTRACT: This study aimed to provide empirical evidence on the effect of the mechanism of good corporate governance on earnings management of both Indonesian and Malaysian manufacturing companies. This research was a quantitative study that used samples of listed manufacturing companies in Indonesia and Malaysia from 2015 to 2017. The sampling method was purposive sampling of 125 Indonesian firms and 107 Malaysian firms. Multiple linear regression was used as a tool to perform data analysis. Results showed that the composition of the board of commissioners has a negative effect on earnings management. Other corporate governance mechanisms such as institutional ownership, managerial ownership, and audit committees showed no influence on earnings management.

1 INTRODUCTION

Earnings reflect a company's performance; they show that a company is being managed in an efficient and effective manner. They also show that it is specifically managed in order to increase profits in accordance with what is desired and beneficial to certain parties and managed efficiently to improve the quality of information. To demonstrate the company's achievements in generating profits, management requires profit with opportunism and manipulation of financial statements to generate profits in accordance with the actual conditions of the company (Abdillah et al., 2016).

Earnings management in a company arises because of a conflict between shareholders (principals) and managers (agents). This conflict between shareholders and managers was articulated in agency theory. Agency theory explains agency relationships that arise with the compilation of one or more people (principles) to help other people (agents) to provide services and then delegate authority to take steps for these agents (Jensen & Meckling, 1976).

Country reports and assessments of the Association of Southeast Asian Nations (ASEAN) Corporate Governance Scorecard (ACGS) published in 2017 show that Indonesia has the lowest corporate governance score. In 2015 Indonesia had a score of 62.68, far below Thailand (87.53), Singapore (78.14), Malaysia (76.91), and the Philippines (73.09). The implementation of good corporate governance in Indonesia and Malaysia has increased from time to time, but this increase has not been able to compete with that of the other ASEAN countries. Indonesia and Malaysia share the same natural and human resources and their economic development policies are related. This led to the researchers' interest in testing the mechanism of good corporate governance with earnings management in Indonesia and Malaysia. Manufacturing companies were chosen as research subjects because the manufacturing business is an investment destination that attracts investors. In addition, this business also has great opportunities in Indonesia and Malaysia that can be used to manipulate financial statements.

The mechanism of good corporate governance in this study is devoted to the concentration of ownership, managerial ownership, the composition of the board of commissioners, and the size of the audit committee.

2 LITERATURE REVIEW

2.1 *Conditional revenue model*

The conditional revenue model was introduced by Stubben (2010) on the basis of dissatisfaction with accrual models that are commonly used today, such as modified Jones models that use the basis of total accruals and the real income derived from the difference between changes in income and changes in accounts receivable.

The conditional revenue model is based on discretionary revenue, which is the difference between actual changes in accounts receivable and prediction changes in accounts receivable based on the model. Accounts that are not normal, high or low, indicate the existence of revenue management (Stubben, 2010). Therefore, Stubben (2010) made an estimate that gave a coefficient of income for the company's credit policy. The following is the formula for the conditional revenue model:

$$\Delta AR_{it} = \alpha + \beta_1 \Delta AR_{it} + \beta_2 \Delta AR_{it} \times SIZE_{it} + \beta_3 \times \Delta AR_{it} \times AGE_{it} + \beta_4 \Delta AR_{it} \times AGE\_SQ_{it} + \beta_5 \Delta AR_{it} \times GRR\_P_{it} + \beta_6 \Delta AR_{it} \times GRR\_N_{it} + \beta_7 \Delta AR_{it} \times GRM_{it} + \beta_8 \Delta AR_{it} \times GRM\_SQ_{it} + \varepsilon_{it}$$

where
AR = accounts receivable at year-end
Rit = revenue year-n
SIZE = natural log of the total asset at year-end
AGE = firm age (years)
GRR_P = industry median adjusted revenue growth (= 0 if negative)
GRR_n = industry median adjusted revenue growth (= 0 if positive)
GRM = adjusted gross margin at year-end
SQ = square of variable
E = error

2.2 *Institutional ownership and earnings management*

Institutional ownership is seen as a party that has capability in the supervision of management, so institutional ownership can optimally reduce earnings management. The research conducted by Liu et al. (2017) examined the effect of institutional ownership on the transparency of company information in companies registered in China. The results of the study provide strong evidence that mutual funds and foreign institutional investors meet the requirements, significantly increasing corporate transparency. The research results of Ismalia and Lina (2015) provide empirical evidence regarding the effect of corporate governance mechanisms on earnings management. The results of this study indicate that ownership concentration has a significant negative effect on earnings management. Furthermore, research conducted by Njah and Jarboui (2013) looked at the relationship between institutional ownership and earnings management behavior of several French acquisition companies. The role of active oversight provided by institutional investors does indeed limit opportunities for earnings management strategies around mergers and acquisitions.

H1: Institutional ownership influences earnings management in Indonesia and Malaysia.

2.3 *Managerial ownership and earnings management*

Managerial ownership is an oversight tool for managers' performance that is internal, so as to reduce agency problems. Research conducted by Ahsan and Haiyan (2012) shows that managerial ownership has a positive effect on controlling the company. The research conducted by Ismalia and Lina (2015) provided empirical evidence regarding the effect of corporate governance mechanisms on earnings management. The corporate governance mechanism in this study is proxied by the concentration of ownership. The results of this study indicate that the composition of the board of commissioners has a significant negative effect on earnings management.

H2: Managerial ownership influences earnings management in Indonesia and Malaysia.

2.4 *Board of commissioner's composition and earnings management*

FCGI (2001) stated that the board of commissioners plays a very important role in the company, especially in the implementation of good corporate governance. The board of commissioners' responsibilities is stated in the General Guidelines for Good Corporate Governance in Indonesia (KNKG, 2006) as a corporate organ that is collectively responsible for supervising and providing advice to directors and ensuring that the company implements good corporate governance. Then the responsibility for supervising the quality of the information contained in financial statements lies with the board of commissioners. Research conducted by Jamaludin et al. (2015) examined the relationship between corporate governance mechanisms and board structure and earnings management. The results provided significant support for the association between the composition of the board of directors and earnings management.

H3: The composition of the board of commissioners influences earning management in Indonesia and Malaysia.

2.5 *Audit committee and earnings management*

FCGI (2001) stated that the responsibility of the audit committee in the field of corporate governance is to ensure that the company has carried out its activities according to applicable laws and regulations, conducted its business ethically, and has carried out its effective supervision of conflicts of interest and fraud committed by company employees. The audit committee plays an important role in controlling the management in the management of the company. Research conducted by Mansor et al. (2013) supported the claim that corporate governance mechanisms are capable of overcoming earnings management activities. The results of the study indicate that independent directors, audit committees, non-duality, audit committee size, internal audit functions, and auditor quality supported the fact that the corporate Governance mechanism can assist in minimizing earning management activities. Research conducted by Miko and Kamardin (2015) showed that discretionary accruals have been used to manipulate accounts and mislead investors. Audit committees and audit quality are believed to contribute to drastically reducing earnings management.

H4: The audit committee influences earnings management in Indonesia and Malaysia.

3 METHOD

This research was a quantitative study of a population of manufacturing companies listed on the Indonesia and Malaysia stock exchanges. The determinations of companies were sampled in this study using the purposive sampling method, and the samples were selected based on the following criteria:

1. Manufacturing companies that were on the Indonesian and Malaysian stock exchanges from 2015 to 2017
2. Manufacturing companies on the Indonesian and Malaysian stock exchanges and have published their annual financial statements in a row.
3. Manufacturing companies on the Indonesian and Malaysian stock exchanges that have completed data on institutional ownership concentration, managerial ownership, board composition, and the size of the audit committee.

Research data were processed using multiple linear regression analysis, which previously had passed the testing of classical assumptions. A t-test was used to test the comparative hypotheses (difference test). An independent sample t-test was used to determine whether or not there are differences in the averages of the two groups that are not related to each other. An independent sample t-test in this study was used to test the significant differences in the means of two unrelated sample groups, namely earnings management in Indonesia and Malaysia.

4 RESULTS AND DISCUSSION

4.1 *The effects of good corporate governance mechanism on earnings management*

The results showed that the value of R^2 is 0.063. It can be concluded that 6.30% of earnings management variables can be explained by the variables of institutional ownership, managerial ownership, independent commissioners, and the size of the audit committee. The remaining 93.70% is influenced by other factors not used in this research model. The F statistical test basically shows whether all the independent variables included in the model have a joint influence on the dependent variable. This test uses criteria for the calculated F value and a significance level of less than 0.05. The results of hypothesis testing showed that institutional ownership variables and managerial ownership have no effect on earnings management in Indonesian and Malaysian companies. Likewise, the audit committee variable also does not show any influence on earnings management. However, the composition of the board of commissioners shows an influence on earnings management in Indonesian and Malaysian companies.

Table 1. Results of the study.

Model	Coefficient	Sig.	
(Constant)	1.012	0.000	***
INS	0.029	0.750	
MNJ	0.074	0.703	
KDK	−0.345	0.021	**
UKA	0.028	0.676	
DAR	0.185	0.018	**
SIZE	−0.018	0.000	***

Dependent variable: EM_SQRTABS

4.2 *Effects of institutional ownership on earnings management in Indonesia and Malaysia*

Based on the results of the statistical t-test, it was observed that the institutional share of ownership did not affect the decline in earnings management practices in both Indonesian companies and in Malaysian companies. The results of this study are in line with the results of the study of Lassoued et al. (2017), who stated that the composition of institutional share ownership actually encouraged earnings management actions. In a study conducted by Lassoued et al. (2017), it was explained that institutional share ownership could not monitor effectively to reduce earnings management. This is because institutional investors tend to prioritize current income rather than long-term income. In addition, institutional investors are passive investors, and when companies whose shares they own underperform, they can quickly withdraw or sell their shares, and this is a driver of management to engage in earnings management in order to show good performance.

4.3 *Effects of managerial ownership on earnings management in Indonesia and Malaysia*

Based on the results of the statistical t-test, it was observed that the managerial share of ownership did not affect the decline in earnings management practices in both Indonesian companies and in Malaysian companies. This is in line with the results of Ismalia and Lina (2015), who found a positive relationship between managerial ownership and earnings management, and this means that the higher the level of share ownership by the management, the higher the level of possibility of the practice of earnings management. These results are certainly not in line with the principles of the application of corporate governance, where company managers must be able to account for their performance transparently and fairly. From the results of the foregoing testing and description, it can be concluded that the composition of managerial share ownership cannot be used as a monitoring tool to reduce the level of possibility of earnings management carried out by company management.

4.4 *Effects of composition of the board of commissioners on earnings management in Indonesia and Malaysia*

The composition of the board of commissioners in this study has a regression coefficient of 0.021, which means that the composition of the commissioners, in this case, independent commissioners, has a negative influence on earnings management practices. This also proves that the composition of the board of commissioners has a negative influence on earnings management in Indonesia and Malaysia, and this is in line with the results of research by Jamaludin et al. (2015) that shows that the composition of the board of commissioners has a significant effect on earnings management. This is in line with the theory of FCGI (2001), where the board of commissioners played a very important role in the company, especially in the implementation of good corporate governance. Thus, it can be concluded that the composition of the board of commissioners can be a monitoring tool in the mechanism of good corporate governance to suppress the practice of earnings management in Indonesia and Malaysia.

4.5 *Effects of the audit committee's size on earnings management in Indonesia and Malaysia*

Based on the results of the statistical t-test, it was observed that the size of the audit committee did not affect the decline in earnings management practices in Indonesian companies and in Malaysian companies. This is in line with the results of Ismalia and Lina (2015), who found a positive relationship between the size of the audit committee and earnings management. The study also explained that the practice of earnings management actually occurs when companies that previously were expected to minimize the occurrence of earnings management practices have a greater number of audit committees.

This result is certainly not in line with the responsibilities of the audit committee mandated in FCGI (2001). This happens because companies tend to appoint or to increase the number of audit committees only to fulfill the indicated regulations so that the function of the audit committee to enforce good corporate governance is not carried out effectively.

5 CONCLUSION

The results of this study indicate that institutional ownership does not affect the decline in earnings management practices in Indonesia and Malaysia. Institutional investors tend to prioritize current income rather than long-term income. In addition, institutional investors are passive investors, and when companies whose shares they own underperform, they can quickly withdraw or sell their shares.

Second, managerial ownership does not affect the decline in earnings management practices in Indonesia and Malaysia. A conflict of interest or agency problem cannot be overcome when the company's shares are also owned by managers. This is because managers have dividend interests that will be obtained from share ownership in the company.

Third, the composition of the board of commissioners influences the decline in earnings management practices in Indonesia and Malaysia. Independent commissioners can be a control tool in the mechanism of good corporate governance to suppress the practice of earnings management where the board of commissioners is at the core of corporate governance that is tasked with ensuring the implementation of the company's strategy, overseeing management in managing the company, and requiring accountability.

Fourth, the size of the audit committee has no effect on decreasing earnings management practices in Indonesia and Malaysia. This is alleged because the company tends to appoint and or increase the number of audit committees only to fulfill the indicated regulations so that the function of the audit committee to enforce good corporate governance is not carried out effectively.

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