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Corporate governance and earnings quality of ASEAN nonfinancial industries

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ABSTRACT: This study examined the mechanism of good corporate governance on earnings quality. Good corporate governance is measured by the proportion of independent commissioners, the proportion of audit committees, the proportion of the board of directors, and audit quality. Discretionary Accruals (DACC) is a proxy for earnings quality. The population of this study is Top 50 and Top 30 in the 2015 ASEAN CG's Scorecard Assessment and reports of financial sectors published from 2014 to 2017. We used a purposive sampling method and obtained sample data of 32 companies. The method of analysis used is multiple linear regression. Results showed that the proportion of the audit committee and the proportion of the board of directors influence the quality of earnings, while the proportion of independent commissioners and audit quality do not affect the quality of earnings.

1 INTRODUCTION

Corporate Governance (CG)'s scorecard assessment for Association of Southeast Asian (ASEAN) countries shows that the average score increases from the previous years. With the phenomenon of an increasing CG scorecard, it is expected that there will be a reduction in the practice of earnings management in companies going public in ASEAN countries. The components of this corporate governance mechanism can improve earnings quality and will control the nature and motivation of managers in carrying out the company's operational performance. Therefore, the effects of strong corporate governance in a company are expected to affect the relationship between earnings management and earnings quality (Chtourou, 2001). There are four corporate governance mechanisms that are used in this study to overcome agency problems: the audit committee, independent board of directors, audit quality, and the size of the board of directors.

Previous research showed inconsistencies in results, which can be due to differences in research samples, years of research, and economic conditions. Therefore, the motivation of this research was to conduct further research on earnings quality, which is expected to provide an explanation for the inconsistencies in the results.

Another difference between this study and previous research is seen in the scope of the study. Previous studies were carried out in companies within a country, whereas we conducted a cross-country study in ASEAN countries, namely Indonesia, Malaysia, Singapore, Philippines, Vietnam, and Thailand, which contributes to the development of this field, especially in countries that are related to these. In practice, this field can be used as a consideration by stakeholders in making investment decisions, especially in assessing earnings quality. Based on the foregoing explanation, this research focused on the quality of earnings between the countries studied and analysis related to other aspects.

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2 LITERATURE REVIEW

Corporate governance is a set of rules that regulate the relationships among shareholders, company managers, creditors, government, employees, and other internal and external stakeholders related to their rights and obligations, or in other words, a system that regulates and controls the company (FCGI, 2001).

2.1 *Proportion of independent commissioners*

From the perspective of agency theory, the board of commissioners or internal management organizations can help align roles and managers (Jensen, 1993), and the external directors would be more effective in monitoring while also giving more expert knowledge and added value to the company (Jensen & Meckling, 1976). This is supported by the research of Hermalin et al. (1991) and Boone et al. (2007), which stated that external directors who are more effective in monitoring are also a means to discipline managers who carry out opportunistic behavior in pursuit of their own interests so that such managers' excesses can be reduced. This is reinforced by the research conducted by Chtourou et al. (2001), Anderson et al. (2003), Boediono (2005), Siallagan and Macfoedz (2006), Oktapiyani (2009), and Nadirsyah et al. (2015), which stated that the board of commissioners proved to be of quality to earnings quality. Based on these studies, the following hypothesis is proposed:

H1: A proportion of independent commissioners affects earnings quality.

2.2 *Proportion of the audit committee*

The audit committee is a monitoring mechanism that is voluntarily formed in a high agency cost situation to improve the quality of information between the principal and the agent (Hadi & Sabeni, 2002). Therefore, managers acting as agents will disclose more transparent company information based on the effectiveness of the audit committee's performance. Research conducted by Wedari (2004), Hermawan and Sulistyo (2005), Siallagan and Macfoedz (2006), Nasution and Setiawan (2007), Oktapiyani (2009), Ismail et al. (2010), Susanti et al. (2010), and Setiany (2013), stated that there was an influence of the audit committee on the quality of earnings. They concluded in their studies that a larger audit committee could provide considerable supervision over the financial reporting process. The second hypothesis is:

H2: A proportion of the audit committee affects earnings quality.

2.3 *Proportion of the board of directors*

A larger size of the board of directors can reduce the effectiveness of supervision because communication and coordination and the ability of the board to control management can lead to agency problems (Jensen, 1993). This is supported by the research conducted by Oktapiyani (2009) and Annisa and Kurniasih (2012) regarding the influence of the board of directors on earnings quality. Based on these studies, the following hypothesis is proposed:

H3: The board of directors affects earnings quality.

2.4 *Audit quality*

Auditing can reduce information asymmetry between managers and stakeholders of the company by allowing outsiders to check the validity of financial statements and increasing the credibility of information to support good corporate governance with the principle of transparency (Jensen, 1993). This is supported by the research conducted by Becker et al. (1998), Francis et al. (2001), Krishnan et al. (2003), Herni and Susanto (2008), and Guna and Herawaty (2010) regarding the effects of audit quality on earnings quality. Based on the findings of these previous studies, the following hypothesis is proposed:

H4: Audit quality affects earnings quality.

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3 METHOD

The population in this study comprised all companies in six ASEAN countries (Indonesia, Singapore, Malaysia, Thailand, Philippines, and Vietnam), which became the Top 50 and Top 30 in the 2015 ASEAN CG's Scorecard assessment of nonfinancial sectors. The sample selection in this study was conducted using a purposive sampling technique, which is a method of determining or sampling with certain considerations (Sugiyono, 2011). Based on the table above, because researchers used purposive sampling in this study, much of data in this study were 32 companies multiplied by the time series from 2014 to 2017, so that the total data consisted of 128 observation data components. This research will explain the effects of Good Corporate Governance Mechanism (Proportion of Independent Commissioners, Audit Committee Proportion, Proportion of Board of Directors, and Audit Quality) on earnings quality as the dependent variables and Debt Level, Sales Growth, and Legal System as control variables. The data were analyzed with descriptive analysis to describe various characteristics of the variables studied. The verification analysis for hypothesis testing of this research was the test of goodness of fit (SPSS).

4 RESULTS AND DISCUSSION

The first hypothesis (H1) proposed in this study states that the independent board of directors influences the quality of earnings. After testing, the proportion of the independent board of commissioners showed a significance probability value of 0.322, which was greater than the specified significance value of 0.05 (0.322 > 0.05). So it can be concluded that the independent board of directors does not affect the quality of earnings. The results of this study are consistent with the results of previous studies by Muid (2009) and Indrawati and Yulianti (2010), which stated that a proportion of the independent board of commissioners has no effect on profit quality. The second hypothesis (H2) proposed in this study states that the audit committee influences the quality of earnings. After testing, the results showed that the significance probability value of 0.007 is smaller than the significant value that has been determined at 0.05 (0.007 < 0.05). It can therefore be concluded that the audit committee influences the quality of earnings. The third hypothesis (H3) proposed in this study states that the board of directors influences earnings quality. After testing, the board of directors showed a significance probability value of 0.049, which was smaller than the significant value that was determined at 0.05 (0.049 < 0.05). It can therefore be concluded that the board of directors has an effect on earnings quality. The fourth hypothesis (H4) proposed in this study states that audit quality influences earnings quality. After testing, the audit quality showed a significance probability value of 0.148, which is greater than the significant value that was determined at 0.05 (0.148 > 0.05). It can therefore be concluded that audit quality does not affect earnings quality.

5 CONCLUSION

Based on the results of data analysis and discussion on the effects of good corporate governance mechanism on earnings quality with variables of control by debt levels, sales growth, and legal system (study across ASEAN countries), the results showed that a proportion of the audit committees and a proportion of the board of directors affect the quality of earnings in ASEAN countries, while a proportion of independent commissioners and audit quality does not.

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