THE IMPACT OF CGPI, COMPANY SIZE, AND LEVERAGE ON EARNINGS MANAGEMENT AND THEIR IMPLICATIONS TO THE INTEGRITY OF FINANCIAL STATEMENTSTLE

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Abstract

In accordance with the problems raised in the study, the purpose of this study is to find out, test, and analyze the effects of CGPI (corporate governance perception index), company size, and leverage on earnings management and their implications for the integrity of financial statements, both partially and simultaneously.The research method used is quantitative data analysis. Sampling using purposive sampling method that result to be eight companies which consistently followed CGPI programs respectively from 2011-2017 and listed on the Indonesia Stock Exchange. Data analysis technique is path analysis and data is processed using SPSS statistic software.The results showed that, in sub-structure 1, CGPI partially had no significant effect on earnings management. While company size and leverage have a significant effect on earnings management. CGPI, company size, and leverage simultaneously have a significant effect on earnings management. In sub- structure 2, CGPI, company size, leverage, and earnings management partially and simultaneously have a significant effect on integrity of financial statements. Earnings management is not an intervening variabel among the relationship of CGPI, company size, and leverage with integrity of financial statements.

Keywords: *CGPI, company size, leverage, earnings management, integrity of financial statements.*

A. Introduction

A large accounting scandal involving a public company, Enron and the big four accounting company, Arthur Andersen that bubbling their income to USD600million and hid billion dollars of debt (A., JR., & Sorkin, 2001). Another scandal recently happened to British Telecom which also involved a famous public accountant Price Waterhouse Coopers (PWC) (Priantara, 2017). These kinds of scandal not only happened in foreign country but also in Indonesia, such as PT. Inovisi Infracom, Tbk. (INVS) that its stock trading was suspended by Bursa Efek Indonesia (BEI) for unsynchronized and errors of financial statement (Ang, 2015). Meanwhile, PT. Timah also been suspected for publishing fictitious financial statement in first semester of 2015 (Soda, 2016). Indonesia public company, PT. Kereta Api Indonesia (Persero), was also detected a different in reported profit and in fact (Budi & Aprianto, 2006).

Integrity of financial statement should have reliability value built in the report. A reliable information is an information that free from misunderstanding, significant error and was presented with faithful representation (Mayangsari, 2003). Conservatism concept is used to create a report that can be accounted for its user. Therefore, it can be regarded as a proxy of integrity of financial statement (Rahiim & Wulandari, 2014). Indonesia has adopted IFRS (International Financial Reporting Standard) since 2012 but only begin to be implemented since 2015. After implementing this standard, financial report was expected to be more valid and more reliable. But it still cannot guarantee there will be no earning managements practice in a company.

Conflict of interest as explained in the agency theory is the main background for a company to conduct an earnings management (Jensen & Meckling, 1976). Several motivations for agent to practice earnings management: 1) to reach internal target; 2) to fulfill internal expectation; 3) income smoothing; and 4) window dressing (Stice, Stice, & Skousen, 2004). The existence of earnings management become a concern if a company adhere to corporate governance value.

Related to the implementation of corporate governance in Indonesia, there is an independent institution called The Indonesian Institute of Corporate Governance (IICG). IICG regularly held a rating program that is known by Corporate Governance Perception Index (CGPI) since 2001. Implementation of corporate governance will enforce a management to create integrated financial statement. Most of the company participate in this rating program has large capitalization in the market. Their existence has more influence to the society and become publicly watched over their activities.

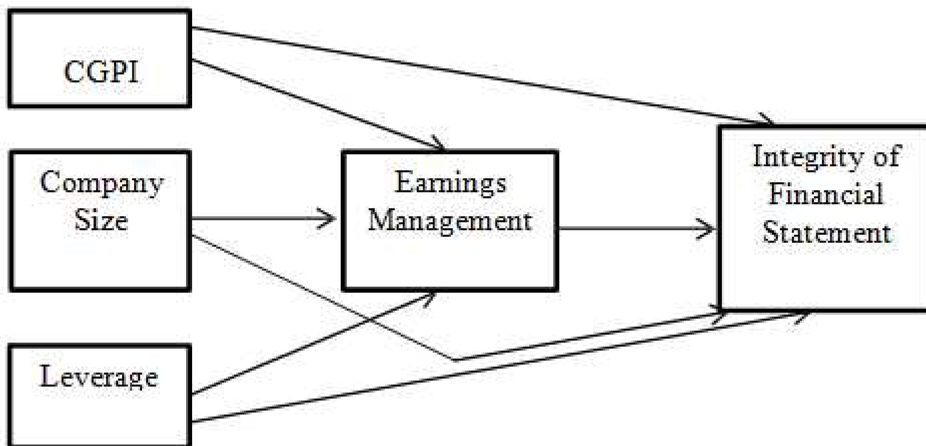
Large companies generally have a strong internal control system so that it will reduce chance for financial reporting errors which will able to minimize the possibility of manipulation of financial statements or earning management (Carslaw & Kaplan, 1991). Another factor that can affect the integrity of financial statement is leverage. Companies that have leverage usually will be very careful in using the fund because the companies will be supervised by their creditor. The greater the leverage, the greater the risk that company should take to fulfill their responsibility for the creditor where the management will move earnings period to meet the requirement ratio.

Based on description above, it underlies this research to analyze the impact of CGPI, company size, and leverage on earnings management and their implications to the integrity of financial statement. Hence, it can be defined that the exogenous variables are CGPI, company size, and leverage, meanwhile the endogenous variable is integrity of financial statement with earnings management as the intervening variable.

Hypotheses for this research are developed as below:

1. CGPI has partial effect on earnings management
2. Company size has partial effect on earnings management
3. Leverage has partial effect on earnings management
4. CGPI, company size, and leverage have simultaneously effect on earnings management
5. CGPI has partial effect to the integrity of financial statement
6. Company size has partial effect to the integrity of financial statement

7. Leverage has partial effect to the integrity of financial statement
8. Earnings management has partial effect to the integrity of financial statement
9. CGPI, company size, leverage, and earnings management have simultaneously effect to the integrity of financial statement
10. CGPI, company size, and leverage have effect to the integrity of financial statement through earnings management



Picture 1. Conceptual Framework

B. Method

This study is using quantitative data analysis. The population for this research is all the companies that was included in corporate governance perception index (CGPI) rating from 2011-2017 and then sampling method is purposive sampling that results for 8 companies which is shown on the table below:

Table 1. Sampling with purposive sampling

Description	Number of companies
CGPI participant for period 2011-2017	74
Inconsistent participant for period 2011-2017	(64)
Consistent participant for period 2011-2017	10

Not public listed company	(2)
Number of sample for study	8

Source: Data processed

Table 2. Sample of Study

No.	Company's name	Stock code
1.	PT Aneka Tambang (Persero) Tbk	ANTM
2.	PT Bank Mandiri (Persero) Tbk	BMRI
3.	PT Bank Negara Indonesia (Persero) Tbk	BBNI
4.	PT Bank Tabungan Negara (Persero) Tbk	BBTN
5.	PT Bank OCBC NISP Tbk	NISP
6.	PT Bank Rakyat Indonesia (Persero) Tbk	BBRI
7.	PT Bukit Asam (Persero) Tbk	PTBA
8.	PT Timah (Persero) Tbk	TINS

Source: Data processed

Corporate Governance Perception Index (CGPI) (x1)

CGPI score in 2011-2016 is tabulated by following composition: Self Assessment (25%); Document (23%); Papers (17%); and Observation (35%), and the composition changed in 2017 by following: Governance Structure (25.75%); Governance Process (43%); and Governance Result (31.25%). Each of the company will be rated by using following scale: Most Trusted (85-100); Trusted (70-84); and Trusted Enough (55-69).

Company Size (x2)

Company size is measured with its market price multiplied by number of outstanding shares, so called market capitalization. Logarithm natural of market capitalization is used to adjust the value to meet the other variabel in this research.

Leverage (x3)

Leverage is to show the portion of assets that is financed by its debt. This research is using leverage by this formula:

$$Lev_{it} = \frac{Debt}{Asset}$$

Description:

$Lev_{it} =$ company leverage i in t period

Earnings Management (y1)

(Stubben, 2010) showed that revenue discretionary in detecting earnings management is less bias and more specific than accrual discretionary, hence, there is a formula developed for revenue discretionary in detecting earnings management.

$$\Delta AR_{it} = \alpha + \beta_1 \Delta R1_3_{it} + \beta_2 \Delta R4_{it} + \varepsilon_{it}$$

Description:

ΔAR_{it} = Revenue accruals company i on period t year
$\Delta R1_3_{it}$ = Revenue q1 to q3 company i on period t year
$\Delta R4_{it}$ = Revenue q4 company i in period t year
ε_{it} = error

Integrity of Financial Statement (y2)

Integrity of financial statement is measured by conservatism concept (Beaver & Ryan, 2000) using book to market (BTM) to get the value.

$$Cons_{it} = \frac{BV_{it}}{MV_{it}} x\ 100\%$$

Description:

$BV_{it} =$ Book value of company i on period t year
$M_{it} =$ Market value of company i on period t year

Data analysis technique used in this research was regression analysis using SPSS version 25 with significance level of 5%. Before testing the research hypothesis, it was first done normality test and find the correlation between each of the variable. Then continue to conduct hypothesis testing using path analysis and Sobel test to examine intervening variable by using 2 equations (Ghozali, 2011).

C. Research Finding

Based on the results of descriptive statistical test using SPSS 25:

Table 3. Descriptive Statistical Analysis

Descriptive					
	N	Minimum	Maximum	Mean	Std. Deviation
x_1	56	77.81	93.86	86.7477	3.36104
x_2	56	28.96	33.29	31.0671	1.21311
x_3	56	.23	.92	.6855	.24521
y_1	56	-.20	1.12	.7070	.29279
Valid N (listwise)	56				

Source: Data processed

Table 4. Correlations

		x_1	x_2	x_3	y_1
x_1	Pearson Correlation	1	.605**	.464**	.115
	Sig. (2-tailed)		.000	.000	.398
	N	56	56	56	56
x_2	Pearson Correlation	.605**	1	.494**	.386**
	Sig. (2-tailed)	.000		.000	.003
	N	56	56	56	56
x_3	Pearson Correlation	.464**	.494**	1	.417**
	Sig. (2-tailed)	.000	.000		.001
	N	56	56	56	56
y_1	Pearson Correlation	.115	.386**	.417**	1
	Sig. (2-tailed)	.398	.003	.001	
	N	56	56	56	56

Source: Data processed

Table 5. Sub-structure 1: R Square Regression

Model Summary[b]				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.514[a]	.264	.221	.25838
a. Predictors: (Constant), x3, x1, x2				
b. Dependent Variable: y1				

Source: Data processed

Table 6. Sub-structure 1: Coefficients Regression

C						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.297	1.126		-.264	.793
	x1	-.024	.013	-.281	-1.823	.074
	x2	.091	.038	.377	2.406	.020
	x3	.431	.168	.361	2.561	.013
a. Dependent Variable: y1						

Source: Data processed

Equation of sub-structure 1:

$$y_1 = -0.281x_1 + 0.377x_2 + 0.361x_3 + 0.883$$

Table 7. Sub-structure 2: R Square Regression

Model Summary[b]				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.756[a]	.572	.538	.27343
a. Predictors: (Constant), y1, x1, x3, x2				
b. Dependent Variable: y2				

Source: Data processed

Table 8. Sub-structure 2: Coefficients Regression

Coe						
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.691	1.193		3.095	.003
	x1	.063	.015	.527	4.308	.000
	x2	-.269	.042	-.811	-6.373	.000
	x3	.388	.189	.237	2.054	.045
	y1	-.395	.147	-.288	-2.693	.010
a. Dependent Variable: y2						

Source: Data processed

Equation of sub-structure 2:

$$y_2 = 0.527x_1 - 0.811x_2 + 0.237x_3 - 0.288y_1 + 0.654$$

Table 9. Direct and Indirect Effect

Variable	Direct	Indirect by y_1	Total
$x_1 \rightarrow y_1$	-0.281		
$x_2 \rightarrow y_1$	0.377		
$x_3 \rightarrow y_1$	0.361		
$x_1 \rightarrow y_2$	0.527	0.081	0.569
$x_2 \rightarrow y_2$	-0.811	-0.109	0.089
$x_3 \rightarrow y_2$	0.237	-0.104	0.073
$y_1 \rightarrow y_2$	-0.288		

Source: Data processed

Table 10. Sobel test

	$\lvert t_{count} \rvert$
$tx_1 y_1$	1.455
$tx_2 y_1$	1.723
$tx_3 y_1$	1.792

Source: Data processed

Table 11. Sub-structure 1: F-test Regression

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.243	3	.414	6.208	.001[b]
	Residual	3.472	52	.067		
	Total	4.715	55			
a. Dependent Variable: y1						
b. Predictors: (Constant), x3, x1, x2						

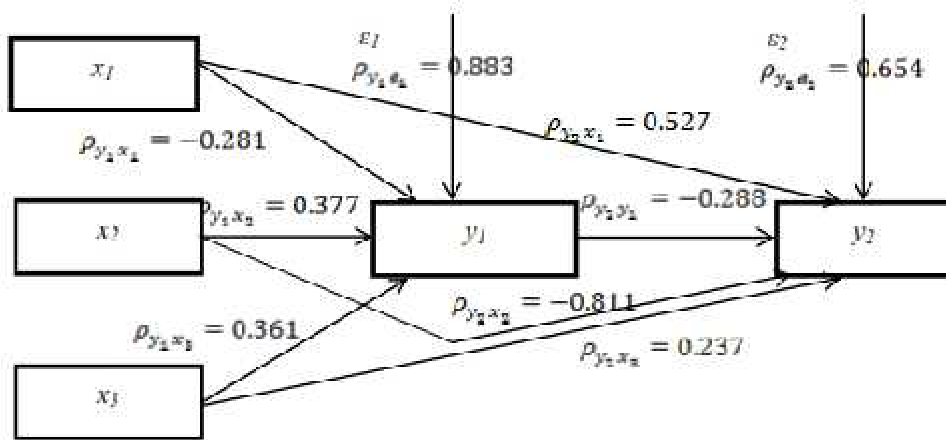
Source: Data processed

Table 12. Sub-structure 2: F-test Regression

ANOVA[a]						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	5.088	4	1.272	17.014	.000[b]
	Residual	3.813	51	.075		

Total	8.901	55		
a. Dependent Variable: y2				
b. Predictors: (Constant), y1, x1, x3, x2				

Source: Data processed



Picture 2. Structural Effect

D. Discussion

CGPI has partial effect on earnings management

Based on the research results obtained that CGPI variable has no effect against management. In theory, the results of this research proves that the existence of differences of interest between a principal and an agent that allow the occurrence of earnings management practices as described in agency theory can be reduced with good corporate governance practices . But this influence is not significant due to the period of research is 2011-2017 where Indonesia began to officially adopt the International Financial Reporting Standards (IFRS) since January 1,

2012. It turns out that the application of IFRS in Indonesia have started to affect the resulted report. The results of this study does not fully support research (Wuryani, 2013), (Vajriyanti, Widanaputra, & Putri, 2015), and (Priharta, Rahayu, & Sutrisno, 2018) stating that CGPI negative effect significantly to earnings management practices.

Company size has partial effect on earnings management

Based on the research proved that company size has effect on earnings management, where it is shown that the larger the size of the company, the company's tendency to practice earnings management was also higher. The size of the company shows the magnitude of the information contained in it, so the size of the company to be a part of or related to public attention with its performance. Major companies serving the financial statements do not comply with the expectations of society tend to will lead to turmoil that can endanger the health of the company. The results of this research in line with the perspective of the political cost hypothesis in the positive accounting theory, which describes a political dimension in selecting accounting policies. Companies with large size tend to be doing such income smoothing earnings management to avoid unexpected turbulence. The results of this research were not in line with the findings (Lee & Choi, 2002), (Saleh, Iskandar, & Rahmat, 2005), (Cornett, McNutt, & Tehranian, 2009), and (Jao & Pagalung, 2011).

Leverage has partial effect on earnings management

Based on the research results proved that leverage has a positive on earnings management. This indicates that the higher the leverage the company tends to do earnings management. Thus, the results of this research in line with the debt covenant hypothesis in the positive accounting theory, that the debtor required to maintain the ratio of debt to equity during the loan agreement period, therefore, the manager of a company that has great leverage ratio will conduct earnings management to meet the requirement. The results of this study support the conclusions of research (Saleh et al., 2005), (Tarjo, 2008), and (Naftalia & Marsono, 2013) which suggests that leverage has positive influence on earnings management.

CGPI, company size, and leverage have simultaneously effect on earnings management

Based on the results of research, F-test of sub-structure 1 retrieved value Fcount of 6,208 > Ftabel of 2.79 and the significance of 0.001 < 0.05 proving that exogenous variables (CGPI, company size, and leverage) simultaneously effect on the endogenous variables (earnings

management) with a 95% confidence level. With the value of the coefficient of determination R2 = 0.264 then goodness of fit test demonstrated that exogenous variables covering the whole of the CGPI, company size, and leverage can explain variations in earnings management of 26.4% and the rest of 73.6% is explained by other factors not present in the model. The next coefficient determination of adjusted (Adjusted R2) of 0.221 show that after considering the degrees of freedom, the entire exogenous variables used only able to explain the variations that occur in the earnings management of 22.1%.

CGPI has partial effect to the integrity of financial statement

Based on the results of the study proved that CGPI has positive effect to the integrity of financial statements. This strengthens the empirical findings of agency theory explains the existence of agency problem in the relationship of principal and agent tend to have a conflict, then corporate governance needed to overcome these problems. A high score on the CGPI shows implementation of effective governance, including financial reporting in accordance with the accounting standards and management practices to avoid earnings management that encourage integrated financial statement. The results of this research in line with the results of the research (Dewi, 2012), (Wuryani, 2013), and (Vajriyanti et al., 2015) which said that CGPI has positive effect to the integrity of financial statement.

Company size has partial effect to the integrity of financial statement

Based on the research proved that size of a company has a negative effect against the integrity of the financial statements. These results indicate that the greater the size of the company, the lesser integration of financial statements presented. This finding in line with (Hamdan, Abzakh, & Al-Ataibi, 2011) which concluded that small company presents report more integrated financial statements. Thus the results of this research were not in line with the signaling theory that large companies have greater information and got more attention from the public. The results of this research turns out more correctly if viewed in the perspective of the political cost hypothesis in the positive accounting theory, which describes a political dimension in selecting accounting

policies. Large sized company has a tendency to do manipulation without knowing due to the very large number presented. Slightly difference which is not significant compared to company value but it is significant for certain people.

Leverage has partial effect to the integrity of financial statement

Based on the research results obtained that leverage has a positive effect to the integrity of financial statements. The empirical findings suggest that use of debt affects the presentation of the financial statements of the company to be more integrated. The company suffered a loss due to the high leverage are likely to require auditors to begin auditing process more slowly than usual. Moreover, in this study the company researched mainly from the banking sector, where in the banking sector, the use of leverage is considerable third-party funds. Banking sector is the most important sector that affects a country economy. Indonesia has several independent institutions to regulate and supervise banks. Thus, banks are restricted to rules and policies which constraint them to manipulate a financial statement. The results of this research supports findings (Kootanaee, Seyyedi, Nedaei, & Kootanaee, 2013), but not in line with the results obtained (Ardison, Martinez, & Galdi, 2008), (Hamdan et al., 2011), (Putra & Muid, 2012), and (Fajaryani, 2015) which generally state that the leverage has negative effect negative to the integrity of financial statements.

Earnings management has partial effect to the integrity of financial statement

Based on the research results obtained that the earnings management has negative effect on the integrity of financial statements. These results suggest that the practice of earnings management will result in the financial statements are presented is not integrated. Thus, this study strengthen the agency theory explains that the separation between ownership and management will force the management to create report that support the management team. The results of this study are in line with the findings in the study (Putra & Muid, 2012), (Sari & Rahayu, 2014), and (Haque, Mughal, & Zahid, 2016) stating that earnings management has negative effect to the integrity of financial statements.

CGPI, company size, leverage, and earnings management have simultaneously effect to the integrity of financial statement

Based on the results of research, F test of sub-structure 2 retrieved value Fcount of 17,014 > Ftable of 2.79 and significance 0.000 < 0.05. This shows that the simultaneous exogenous variables (CGPI, company size, leverage, and earnings management) simultaneously affects endogenous variables (the integrity of financial statements) with a 95% confidence level.With the value of the coefficient of determination R2 = 0.572 then goodness of fit test demonstrated that exogenous variables covering the whole of the CGPI, company size, and leverage can explain variations in integrity of financial statements of 57.2% while the rest of 42.8% is explained by other factors not present in the model. The next coefficient determination of adjusted (Adjusted R2) of 0.538 show that after considering the degrees of freedom the entire exogenous variables used are capable of explaining the variations that occur in the integrity of financial statements of 53.8%. This means there is still a 46.2% which is the influence of other factors that have not been examined in this study.

CGPI, company size, and leverage have effect to the integrity of financial statement through earnings management

From the Sobel test results of the calculation to the direct and indirect influence appear that CGPI, company size and leverage does not affect the integrity of financial statement through earning managements. This is due to the application of IFRS as early as 2012 which put forward the principle of prudence in preparing financial statements. Empirical evidence shows that the application of International Financial Reporting Standard (IFRS) with the fair value of his apparently does not eliminate the practice of accounting conservatism. This is in line with research (Setiani, 2013) shows that there is no difference in faithful representation, comparability, and timeliness before and after adoption of IFRS. (Rahayu & Cahyati, 2015) also state that there is no significant information asymmetry differences before and after the convergence of IFRS.

E. Conclusion

Based on the results of the hypothesis test, the conclusions in this study are in sub-structure 1, CGPI partially had no significant effect on earnings management. While company size and leverage have a significant effect on earnings management. CGPI, company size, and leverage simultaneously have a significant effect on earnings management. In sub-structure 2, CGPI, company size, leverage, and earnings management partially and simultaneously have a significant effect on integrity of financial statements. Earnings management is not an intervening variabel among the relationship of CGPI, company size, and leverage with integrity of financial statements.

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