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EFFECT OF LEVERAGE, GOOD CORPORATE GOVERNANCE AND FIRM SIZE ON EARNING MANAGEMENT: STUDY ON BANKING COMPANY

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ABSTRACT

This purpose of this study to determine the effect of leverage, good corporate governance and firm size on earning management. The analysis used in this study are multiple regression for the period 2012-2017. The results of the study showed that leverage has positive and significant effect on earning management, good corporate governance has negative and significant effect on earning management. Morever, the firm size has no effect on earning management.

KEYWORDS: ***Earning Management, Leverage, Good Corporate Governance, Firm Size***

INTRODUCTION

Earnings management is a management action in the process of preparing financial statements by increasing or decreasing accounting profits in accordance with their interests (Scott, 2015; Indracahya dan Faisol, 2017). However, earnings management also has a negative impact on the company where earnings management will reduce the credibility of the financial statement issuing company and reduce the company's ability to improve earnings quality. Andison (2017) states that companies that do earnings management tend to reveal less information in their financial statements so that they are not detected.

Earnings management actions occur because the management as a company manager knows more about internal information and future company prospects compared to the owner of the company. Utami (2006) states that opportunistic management actions are carried out by using certain accounting policies so that company profits can be adjusted as desired. Agency theory assumes that each individual is motivated by his own interests, giving rise to a conflict of interest between the interests of the principal and the interests of the agent. Besides that, the assumption is that individuals act to maximize themselves, resulting in agents utilizing the information asymmetry they have to hide information that is not known to the principal.

The phenomena is like the Toshiba accounting scandal (Yoga, 2015), where the former Tokyo prosecutor as chairman of the company's independent team revealed that the top leadership of Toshiba Corporation was "systematically" involved in the company's 1.2 billion dollar inflating scandal over several years. In addition, the case of PT. Bank Bukopin, Tbk. There are cases of earnings revisions. Based on the OJK report where the 2016 earnings were audited with the net profit of Rp. 1.09 trillion, the latest report was revised to a profit of Rp. 183.54 billion. The profit revision was reported to have occurred because Bukopin tripped over a credit card case. This error occurred in 2016 regarding the presentation of data from the credit card business, but it was only detected in 2017.

One of the factors that influence earnings management is leverage (Darabali, 2016). Companies with high leverage indicate that debt is more used in corporate financing (Darabali, 2016). The level of corporate debt (leverage) can affect earnings management actions. High leverage caused by management errors in managing company finances or the implementation of strategies that are less appropriate from the management. Because of the lack of supervision that causes high leverage, it will also increase opportunistic actions such as earnings management to maintain performance in the eyes of shareholders and the public (Naftalia and Marsono, 2013).

Ardison et. al., (2012) in his research that examined the effect of leverage on earnings management in companies listed on the Brazil State Stock Exchange in the period 1994-2010. In the tests carried out obtained results that the leverage ratio has a positive effect on abnormal accruals. This proves that the higher the leverage ratio will increase earnings management actions, as evidenced by the results of increasing abnormal accruals carried out by the company. This result is in line with Warrad (2017), examining the effect of leverage and profitability on earnings quality as measured by abnormal accrual discresionary. Naftalia and Marsono (2013) in their study prove that leverage ratios do not affect earnings management by using acrual discresionery.

In addition, the factors that influence earnings management are good corporate governance (Shiri et. Al., 2012). The application of Good Corporate Governance (GCG) is one of the significant efforts to escape the economic crisis that hit Indonesia. Good Corporate Governance is an issue that is being discussed as a tool that can solve problems in management and corporate responsibility. To limit the emergence of agency problems, a series of mechanisms is called good corporate governance.

Shiri et. al., (2012), namely research conducted at the Tehran company. in his research proves that good corporate governance has a negative effect on earnings management. It is concluded that good corporate governance can overcome conflicts of interest between agents and principles that occur within the company. The higher good corporate governance can reduce disresionary accruals. In addition, the Chelogoi (2012) study examined the effect of corporate governance on earnings management in companies listed on the Kenya Stock Exchange for the period 2005-2012. From the results of testing, independent commissioners and audit committees have a negative effect on earnings management. But CEO Duality has no effect on earnings management.

Patrick et, al., (2015) examined the effect of corporate governance on earnings management. From the test results it was found that corporate governance as measured by an independent board size, board had a positive and significant effect on earnings management. Cases like this show a failure of corporate governance that has an impact on the low quality of information in financial statements. Lin and Hwang (2010), a good corporate governance structure helps ensure that management truly utilizes company resources for the benefit of the owner, and reports fair financial conditions and operational performance of the company.

Besides that, the firm size also affects earnings management (Liukani, 2013). The firm size is the amount of assets owned by the company, the greater the firm size, the external parties will pay more attention to the company, so the preparation of financial reports is more qualified (Darabali, 2016). The firm size relates to earnings management because the greater the size of a company, the continuity of the business of the company will be higher in improving financial performance so the company does not need to practice earnings manipulation (Meliati, 2011). Muliati (2011); Nariastiti and Ratnadi (2014) found that company size with earnings management had a negative effect. Large companies lack motivation to practice earnings management. This is because shareholders and interested parties in large companies are considered more critical than small companies. A larger investor base is found in large companies, so large companies get stronger pressure to be able to display reliable financial reports.

Liukani (2013), in his research proves that firm size has no effect on earnings management actions performed on companies on the Albania State Stock Exchange. In contrast to the findings of Swastika (2013) examining the effect of corporate governance, firm size on earnings management. The study was conducted on food and beverage sector companies listed on the Indonesia Stock Exchange in 2005 with a sample of 51 companies. From the test results obtained evidence that corporate governance implementation and firm size have a positive and significant effect on earnings management.

METHOD

Population of this study is a companies included in the ranking of the CGPI report conducted by the Indonesian Institute for Corporate Governance (IICG) in 2012-2017. The research sample was obtained using purposive sampling method with the following criteria: (1) Banking Companies listed on the Indonesia Stock Exchange in 2012-2017; (2) Banking companies that are included in the participant rating of the Corporate Governance Perception Index (CGPI) published by The Indonesian Institute for Corporate Governance (IICG) in 2012-2017; (3) Banking companies that have complete data for the 2012-2017 observation periode.

Table 1. Samples

	Number of samples
The number of companies listed on the Indonesia Stock Exchange participates in the CGPI ranking for the period 2012-2017	34
Less:	22
Non-bank companies which include CGPI ratings for the period 2012 to 2017	
Banking companies not listed on the Indonesia Stock Exchange for the 2012-2017 period	6 **6**
Number of Samples	

Based on table 1, the number of companies listed on the Indonesia Stock Exchange which as participants of the Corporate Governance Perception Index (CGPI) from 2012 to 2017 have 34 companies, 22 non-bank companies in the period 2012-2017 and banking companies that do not have complete data are 6 companies. So that the sample which is a banking company amounts to 6 companies with a year of observation of 6 years, namely 2012-2017, so that the number of samples is 36 companies.

The level of significance of the effect independent variable (x) and the dependent variable (y), it is necessary statistical model to test the hypothesis set. Therefore, the research hypothesis formulated indicates the causality study, the technique used to analyze the level of significance for the independent variable on the dependent is a multiple linear regression model (multiple regression analysis).

$EM = \alpha + \beta_1 LEV + \beta_2 GCG + \beta_3 SIZE + e$ (1)

EM = earnings management is measured using accrual discretionary revenue; LEV = leverage measured by the ratio of total debt to total assets; GCG = good corporate governance as measured by the Corporate Governance Perception Index; SIZE = firm size measured by the log of total assets.

RESULTS AND DISCUSSION

Descriptive statistics for the number of test samples are 36 companies period of 2012-2017. This test includes testing the minimum value, the value of maximum, average and standard deviation. Descriptive statistical results:

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
EM	36	-0.89	1.32	0.30	0.55
LEV	36	0.78	0.91	0.85	0.03
GCG	36	0.85	0.94	0.88	0.03
SIZE	36	7.90	9.05	8.59	0.36

EM: earning management; LEV: *leverage*; GCG: *good corporate governance*; SIZE: firm size

Based on the results of testing descriptive statistics in table 2 on the number of samples of 36 banking companies in the period 2012-2017, a description of earnings management was measured by discretionary accrual from income, namely the mean value 0.30, the minimum value was -0.89 and the maximum value was 1.32 with a standard deviation of 0.55. Leverage as measured by the ratio of total debt to total assets, this ratio describes the ability of total debt financed by company assets with a minimum value of 0.78 and a maximum value of 0.91, the mean value is 0.85 with a standard deviation of 0.03. Good corporate governance variable measured by CGPI which is how well corporate governance is seen from the index value, where the mean value for the good corporate governance variable is 0.88, the minimum value is 0.85 and the maximum value is 0.94, the standard deviation is 0.03. Firm size is measured by the logarithm of total assets, it is known that the mean value is 8.59, the minimum value is, 7.90 and the maximum value is 0.05 with a standard deviation of 0.36.

Table 3. Results

Model	Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
Constant	10.984	8.098		1.356	.181
LEV	9.754	4.136	.604	2.358	.025
GCG	-5.402	5.537	-.246	-.976	.037
SIZE	.279	.296	.181	.941	.594
F Statistik					4.216
Sig. F					.009
R^2					.235
DW					1.335

Significant: 5%

EM: earning management; LEV: *leverage*; GCG: *good corporate governance*; SIZE: firm size

Based on the hypothesis testing in table 3, where in the first hypothesis (1) the effect of leverage ratio on earnings management the regression coefficient value (β) is obtained at 9.754. This result proves that every increase in the value of the 1 unit leverage ratio will increase earnings management by 9,754 units assuming other independent variables remain. While the significance value is 0.025 <0.05, this result proves that leverage has a positive and significant effect on earnings management. The greater the leverage ratio, the higher the value of the company's debt. Watts and Zimmerman (in Sulistyanto, 2008) stated in the debt covenant hypothesis that debt covenant motivation is caused by the emergence of contractual agreements between managers and companies based on managerial compensation. Thus, a company that has a high leverage ratio, means the proportion of its debt is higher than the proportion of its assets will tend to manipulate in the form of earnings management. High leverage is caused by management errors in managing company finances or the implementation of strategies that are not appropriate from the management. Therefore, the lack of supervision that leads to high leverage will also increase opportunistic actions such as earnings management to maintain performance in the eyes of shareholders and the public (Naftalia and Marsono, 2013).

This research supported Ardison et. al., (2012) prove that leverage has a positive and significant effect on earnings earnings management in companies listed on the Brazil State Stock Exchange in the period 1994-2010. Warrad (2017) in his research also proved that leverage has a positive and significant effect on abnormal discretionary accruals. It can be concluded that a high leverage ratio can improve earnings management actions in a Sharia Bank company found in the Jordanian Stock Exchange in the period 2011-2015. In contrast to Zamri's findings, et. Al., (2013) in his research conducted on companies listed on the Malaysia Stock Exchange for the period 2006-2016 with a sample size of 3,745 companies and using real earnings management adoption of Roychowdhury (2006). From the test results prove that leverage has a negative effect on real earnings management.

The second hypothesis (2), the effect of good corporate governance on earnings management, obtained a coefficient (β) value of -5,402, where every increase in 1 unit of good corporate governance will reduce earnings management by 5,402 units with a significance value of 0.037 <0.05. that the variables of good corporate governance have a negative and significant effect on earnings management. Good corporate governance is a process and structure due to regulatory mechanisms used to direct and manage the company for the better. With good corporate governance, it is expected that the quality of financial statements will be properly assessed by investors. Elements and mechanisms of good corporate governance can reduce earnings management actions and will control the nature and motivation of managers in carrying out the company's operational performance. Therefore, the implications of a strong GCG in a company will reduce earnings management actions (Rifani, 2013).

Good corporate governance is one way to prevent conflicts of interest between agents and principals through supervision. Corporate governance based on agency theory is expected to function as a tool to convince investors that they will still get profits from the investment that has been made to the company. Thus, Corporate Governance is expected to function also to suppress or reduce the cost of agency costs. This study is in line with Shiri et. al., (2012) research conducted at the Tehran company. in his research proves that the corporate governance mechanism has a negative effect on earnings management. It is concluded that the corporate governance mechanism can overcome conflicts of interest between agents and principles that occur within the company. The higher good corporate governance can reduce disresionary accruals. In addition, the Chelogoi (2012) study examined the effect of corporate governance on earnings management in companies listed on the Kenya Stock Exchange for the period 2005-2012. From the results of testing, independent commissioners and audit committees have a negative effect on earnings management.

The third hypothesis (3), the effect of firm size on earnings management obtained regression coefficient value (β) that is 0.279 with a significance value of 0.354> 0.05, where the third hypothesis (3) is rejected, it can be concluded there is no influence of firm size variables on earnings management. The firm size stated by total assets shows that the greater the total assets owned by a company, the greater the size of the company. If a company has a large number of assets, this reflects that the company has a relatively more stable condition and is able to generate greater profits compared to companies that have only a small total assets.

Large companies usually have a large role as broader stakeholders. This makes a large number of policies within the company will have a major impact on the public interest compared to small companies. The greater the company will tend not to sharpen profits, because large companies are politically more attention from the government and society compared to small companies, so they are more careful and accurate in conducting financial reporting.

This research supports Luikani's (2013), firm size has no effect on earnings management actions performed on companies on the Albania State Stock Exchange. Large companies lack motivation to practice earnings management. This is because shareholders and interested parties in large companies are considered more critical than small companies. A larger investor base is found in large companies, so large companies get stronger pressure to be able to display reliable financial reports. Unlike the findings of Ali et. al., (2015), tested the effect of company size on earnings management. This research was conducted on textile sector companies in Pakistan for the period 2004-2013. From the test results obtained evidence that the firm size has a positive and significant effect on earnings management.

CONCLUSSIONS AND SUGGESTIONS

A. Conclussions

Based on the results of hypothesis testing, leverage ratio has a positive and significant effect on earnings management. The greater the leverage ratio, the higher the value of the company's debt. High leverage is caused by management errors in managing company finances or the implementation of strategies that are not appropriate from the management. Therefore, the lack of supervision that leads to high leverage will also increase opportunistic actions such as earnings management to maintain performance in the eyes of shareholders and the public.

Good corporate governance has a positive and significant effect on earnings management. With good corporate governance, it is expected that the quality of financial statements will be properly assessed by investors. Elements and mechanisms of good corporate governance can reduce earnings management actions and will control the nature and motivation of managers in carrying out the company's operational performance. Therefore, the implications arising from strong GCG in a company will reduce earnings management actions.

Firm size does not affect earnings management. Large companies usually have a large role as broader stakeholders. This makes a large number of policies within the company will have a major impact on the public interest compared to small companies. The greater the company will tend not to sharpen profits, because large companies are politically more attention from the government and society compared to small companies, so they are more careful and accurate in conducting financial reporting.

B. Suggestion

The next study can use a proxy measurement of other earnings management as delivered by Rochowdhury (2006) through discretionary accrual real activity. This is based on the measurement by Stubben (2010) only calculating accrual discretionary through income alone without taking into account discretionary accruals through expense. In addition, it can expand the sample of research, namely non-financial companies because non-financial companies such as manufacturing have high capacity of fixed assets in the company plays an important role both in production, fixed assets is one of the assets of the company used to carry out its operations, high fixed asset capacity encourage companies to choose methods that will influence earnings management actions (Tay, 2009).

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