THE INFLUENCE OF CORPORATE GOVERNANCE, COMPANY SIZE, AND LEVERAGE TOWARD EARNING MANAGEMENT

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Abstract

The purpose of this study is to examine the influence of GCG variables, firm size, and leverage on earnings management.

The sample used is 35 public listed property and real estate-companies in the Indonesia Stock Exchange (IDX) from 2015 until 2017. The sampling technique uses purposive sampling. This study uses multiple regression.

The results of the analysis showed that managerial ownership does not have a negative effect on earnings management but oppositely, it has a positive effect on earnings management, while company size does not have any effect on earning management.

Keywords: Corporate governance, company size, leverage, dan earning management

Submission date: 2019-07-17

Accepted date: 2019-08-14

INTRODUCTION

Earnings management is a condition where the management intervenes in the process of preparing a financial report for stakeholders so that it can flatten, raise, and lower earnings. Thus, the financial report received by investors or shareholders of the company or external companies sometimes is not the same as happened. In other word, the financial statements have been manipulated by management for the sake of unilateral interests. If this happens, the external parties will suffer losses as well as the owner of the company.

Corporate governance is one way to control opportunistic actions taken by management. There are five principles in Good Corporate Governance/GCG (transparency, accountability, responsibility, independence, and fairness) are created to protect the interests of all stakeholders (FCGI & ADB, 2001). The implementation of Corporate Governance concept is expected to raise oversight and transparency in a
company, so that Corporate Governance acts as a factor, which influences the behavior of management as mention by (Watts, 2003) which stated the implementation of Corporate Governance as one of the ways to monitor contract issues and reduce the management’s opportunistic behavior. The practice of earnings management has been indicated to arise as an impact on agency problems or agency theory. Agency theory occurs because of the conflict of interests between company owners and management (Jensen & Meckling, 1976). The agency problems, motivated principals, enter into contracts to maximize interests for their welfare by increasing profits. Because of agency problem, principals are motivated to maximize their welfare by entering into contract by increasing the company’s earnings, while agents are motivated to maximize the fulfillment of their economic and psychological needs in terms of obtaining investments, loans, or compensation contracts. Leverage is one effort to increase company profits. Companies that have high financial leverage due to the size of debt or liabilities compared to assets owned by the company, it is suspected that earnings management is caused by the company being threatened by default, which means that the company cannot fulfill its debt repayment obligations on time (Shanti & Yudhanti, 2007).

From several studies on the influence of corporate governance, company size, and leverage on earnings management found differences in research results. Corporate governance factors include institutional ownership, management ownership, as well as the size of the board of commissioners and leverage. Also, the results of these studies are still less convincing or less consistent, which can be seen from the research by (Veno & Sasonko, 2016) stated that committees audit and managerial ownership influence earnings management. Similarly, research conducted by (Jao & Pagalung, 2011), which states that managerial ownership and institutional ownership and audit committees have an influence on earnings management, but leverage does not affect. Another thing with ownership management, the audit committee does not affect earnings management, but leverage affects earnings management.

An agency relationship is defined as one in which one or more persons (the principals) engages another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent Jensen and Meckling, 1976 (Ross, 1973). The cornerstone of agency theory is the assumption that the interests of principles and agents diverge. According to agency theory, the principal can limit divergence from his/her interests by establishing appropriate incentives for the agent, and by incur-ring monitoring costs designed to limit opportunistic action by the agent. Further, it may pay the agent to spend resources (bonding costs) to guarantee that he/she will not take certain actions that would harm the principal, or to ensure that the principal will be appropriately compensated if helshe takes such action. That is, the agent may incur ex-ante bonding costs in order to win the right to manage the resources of the principal. Despite these devices, it is recognized that some divergence between the agent’s actions and the principal’s interests may remain. Insofar as this divergence reduces the principals’s welfare, it can be viewed as a residual loss.

LITERATURE REVIEW

The earnings management, according to (Setiawati & Na’im, 2000), is a management intervention in the external financial reporting process to benefit itself. Whereas according to (Wedari, 2004) earnings management is earnings manipulation
carried out by management to achieve certain goals. This manipulation is done so that profits look as expected, other than that it aims to keep investors interested in the company.

(Jones, 1991) identified earnings management by measuring discretionary accruals. He stated that issuers conduct earnings management with an income increasing pattern that will have positive discretionary accruals and if discretionary accruals are negative for protection import from the government.

Managerial ownership is the separation of ownership between the outsider and the insider, if a company has many shareholders, then the large group of individuals is unable to participate actively in the daily management of the company (Bodie & Alan, 2006). (Melinda & Sutejo, 2008) measures managerial ownership by the number of company shares owned by managers and commissioners. (Lamora, Vince, & Kamaliah, 2014) stated that with the ownership of shares held by managers, managers would act in harmony with the interests of shareholders to minimize the opportunistic behavior of managers. Management ownership can be measured by using a ratio scale that is by the percentage of shares held by the management of all outstanding company stock capital (Guna & Herawaty Arleen, 2000).

Hypothesis Development

Management ownership decreases, the incentives for the possibility of the opportunistic behavior of managers will increase (Jao & Pagalung, 2011). With regard to the effects of managerial ownership on managers’ incentives, economics theory identifies two types: the incentive alignment effect and the management entrenchment effect. The literature on traditional agency theory argues that shareholdings held by managers help align their interests with those of shareholders (Jensen & Meckling, 1976). This incentive alignment effect is expected to have more impact as managerial ownership increases, suggesting that as managerial ownership increases, corporate performance increases and opportunistic managerial behavior decreases monotonically. The results of the research conducted by (Veno & Sasongko, 2016) state that there is an effect of managerial ownership on earnings management. Based on such a description, the hypothesis is formulated as follows:

**H1: Managerial ownership has a negative effect on earnings management.**

Company ownership may consist of institutional ownership and individual ownership or a mixture of both with a certain proportion (Nuraina, 2012). Institutional ownership is the ownership of company shares owned by institutions or institutions such as insurance companies, banks, investment companies, and ownership of other institutions (Tarjo, 2008). Institutional ownership is the proportion of shares held by institutions such as insurance companies, pension funds, or other companies measured by the percentage calculated at the end of the year. Institutional ownership can be measured using a percentage indicator of the number of shares held by an institution from all share capital circulating in the stock market (Boediono, 2005).

Institutional ownership has a negative influence on the practice of earnings management, where the smaller the percentage of institutional ownership, the greater the existence of managerial trends in making certain policies to manipulate earnings reporting (Werner R. Murhadi, 2009). This statement is supported by the results expressed by (Jao & Pagalung, 2011). However, this is different from the research
conducted by (Guna & Herawaty Arleen, 2000) which states that institutional ownership does not affect earnings management, nor is it revealed in a study conducted by (Agustia, 2013). Based on such a description, the hypothesis is formulated as follows:

**H2: Institutional ownership has a negative effect on earnings management**

Leverage is the use of assets and sources of funds (source of funds) by companies that have fixed costs (expenses) to increase the potential profits of shareholders (Sartono, 2001). According to (Barus & Leliani, 2013) leverage ratio is the ratio that exists in financial statements that can find out how much the company is financed by debt with the ability of the company described by capital, or it can also show some of the assets used as the guarantor of the debt. (Radyasinta & Kusmuriyanto, 2014) concluded that companies that have a high leverage ratio mean having a proportion of debt that is higher than the proportion of assets will tend to manipulate in the form of earnings management. Variable leverage can be calculated using a ratio of total liabilities (short-term debt and long-term debt) to the total assets owned by the company at the end of the year.

Leverage is the ratio between total liabilities and total assets of the company (Agustia, 2013). This ratio will show the number of assets owned by companies financed by debt. The results of research conducted by (Agustia, 2013), (Guna & Herawaty Arleen, 2000) show that leverage affects earnings management. Based on such a description, the hypothesis is formulated as follows:

**H3: Leverage has a positive effect on earnings management.**

Company size is a company structure that shows the scale of a company. The size of the company shows the amount of experience and ability to grow a company that indicates the ability and level of risk in managing investments provided by investors to increase their prosperity (Apriyani, 2013).

The size of the company influences investors' decision making; large companies will be more trusted by investors to invest their capital; in the end, large companies have less possibility to practice earnings management. The statement is by the results of a study conducted by (Prasetya & Gayatri, 2016) that firm size has a negative effect on earnings management. Based on such a description, the hypothesis is formulated as follows:

**H4: Firm size has a negative effect on earning management.**

**Conceptual Framework**

Earnings management is earnings manipulation conducted by management to achieve certain goals. The motivation of this manipulation is to keep.
METHODS

This research was conducted to test the hypothesis. The independent variables were managerial ownership, institutional ownership, leverage, and company size; while the dependent variable studied was earnings management. This research was carried out in real environmental situations with a public company analysis unit. The time dimension used in this study is pooling data so that it will use SPSS data processing tools. The population in this study are all property and real estate companies listed on the Indonesia Stock Exchange (IDX) during the period 2015-2017. The sampling technique was done by purposive sampling to get a representative sample according to the specified criteria. Property and real estate companies listed Indonesia Stock Exchange (IDX) during 2015-2017 and financial statements in Rupiah (IDR), Companies which do not delist and IPO’s during 2015-2017, companies have positive earnings (Net income, Operating Income).

The dependent variable in this study is earnings management with a ratio scale measurement as measured by the Discretionary Accruals (DA) proxy that uses the Kothari model. This measurement is based on research conducted by (Khotari, Leone, & Wesley, 2001).

Discretionary accruals are calculated using the total accruals (TA): \( TA_t = NCA_t - CL_t \)

Then measured with NDA (non-discretionary accrual/NDA):

\[
NDA_t = \alpha_0 + \alpha_1 \left( \frac{1}{At-1} \right) + \alpha_2 \left( \frac{\Delta REV_t - \Delta ARR_t}{At-1} \right) + \alpha_3 \left( \frac{PPE_t}{At-1} \right) + \alpha_4 \ ROA_{t-1} + \epsilon
\]

Discretionary Accrual (DA) can be measured as follows: \( DA_t = \left( \frac{TA_t}{At-1} \right) - NDA_t \)

**Descriptions:**
- \( TA_t \) = Total Accrual in period
- \( NCA_t \) = Current Asset
- \( CL_t \) = Change Non Current Liability
- \( NDA_t \) = Discretionary Accrual
- \( \Delta REV_t \) = Change in Earning

![Figure 1 Conceptual Framework](image-url)
Institutional ownership is the ownership of company shares owned by institutions or institutions such as insurance companies, banks, investment companies, and ownership of other institutions (Tarjo, 2008).

**Institutional Ownership:** \[
\frac{\text{Total Institutional Share}}{\text{Total Company Share}}
\]

Managerial ownership is several share ownership by management to the total number of shares outstanding (Jao & Pagalung, 2011).

**Managerial ownership:** \[
\frac{\text{Management Share}}{\text{Total Company Share}} \times 100\%
\]

Leverage is the use of assets and sources of funds by companies that have fixed costs to increase the potential profits of shareholders (Sartono, 2001). Leverage is measured by:

**Leverage ratio:** \[
\frac{\text{total liability}}{\text{total asset}}
\]

Company size is a company structure that shows the scale of a company. Company size shows the amount of experience and ability to grow a company that indicates the ability and level of risk. Company size can be calculated by:

**Firm Size = Ln Total Asset**

Research Regression Model

Hypothesis testing is done by multiple regression analysis using the regression equation as follows:

\[
EM = \beta_0 + \beta_1 \text{KM} + \beta_2 \text{KI} + \beta_3 \text{LEV} + \beta_4 \text{CS} + e
\]

**Descriptions:**
- \(\beta_0 = \) Constant
- \(\beta_1,2,3,4,5,6, = \) Regression Coefficients of Each Proxy
- EM = Earning Management
- KM = Managerial Ownership
- KI = Institutional Ownership
- CS = Company Size
- LEV = Leverage
- e = error
DISCUSSION

Based on the criteria of the sample used, the following data are obtained:

| No. | Descriptions                                                                 | Total |
|-----|-----------------------------------------------------------------------------|-------|
| 1   | Property and real estate companies listed on Indonesia Stock Exchange (IDX) during 2015-2017 and financial statements in Rupiah (IDR) | 48    |
| 2   | Companies delisting and IPO’s during 2015-2017                              | (6)   |
| 3   | Companies have negative earnings (Net Income, Operating Income)              | (7)   |
| 4   | Total Companies in the research period 2015-2017                            | 35    |
| 5   | Total Data in research period 2015-2017 (35 companies x 3 years)            | 105   |
| 6   | Outlier                                                                     | (15)  |

Total Data 90

The number of samples: 90 samples, so taking into account that the number has exceeded the minimum sample size (n=30) in the research conducted for correlational studies and causal-comparative studies.

Descriptive Statistics

Descriptive statistical analysis tables are presented as follows:

|                  | N  | Minimum | Maximum | Mean    | Std. Deviation |
|------------------|----|---------|---------|---------|----------------|
| KM               | 90 | .0000   | .0786   | .007136 | .0174390       |
| KI               | 90 | .1616   | .9947   | .727737 | .2124626       |
| LEV              | 90 | .1057   | .7873   | .407769 | .1547495       |
| CS               | 90 | 25.8920 | 31.4580 | 29.250644 | 1.3118177   |
| EARNING MANAGEMENT | 90 | -.1962 | .2173 | .009204 | .0717089 |

Valid N (listwise) 90

The managerial ownership variable, the statistical results show that the minimum value is -0.000, and the maximum value is 0.0786. The average value of the company value generated from 90 samples is 0.0071.

The institutional ownership variable, the statistical results show that the minimum value is -0.1616, and the maximum value is 0.9947. The average value of the company value generated from 90 samples is 0.7277.

The leverage variable, the statistical results show that the minimum value is 0.1057, and the maximum value is 0.7873. The average value of the company value generated from 90 samples is 0.4077.

The company size variable, the statistical results show that the minimum value is 25.89, and the maximum value is 31.45. The average value of the company value generated from 90 samples is 29.25.
The earning management variable, the statistical results show that the minimum value is -0.1962, and the maximum value is 0.2173. The average value of the company value generated from 90 samples is 0.0092.

Multicollinearity test aims to test whether the regression model found an indication of a correlation between independent variables. The Multicollinearity Test results are presented in the following table:

| Variable | VIF   | Tolerance |
|----------|-------|-----------|
| KM       | .883  | 1.132     |
| KI       | .923  | 1.083     |
| LEV      | .776  | 1.288     |
| CS       | .807  | 1.239     |

The results of the VIF Test show that the four independent variables did not occur due to the VIF value of each independent variable <10 and the tolerance value of each independent variable > 0.1.

Autocorrelation test was used to test linear regression models about the effect of data from previous observations. The Autocorrelation Test results are presented in the following table:

| Predictor: KM, KI, LEV, CS |
|---------------------------|
| Dependent: Earning Management |
| Durbin-Watson: 1.901 |

The Durbin-Watson test results in table 4 show a DW value of 1.901; while in the Durbin-Watson (DW) table for "k" = 4 and N = 90 large Durbin-Watson table: dl (outer limit) = 1.5656 and du (inner limit) = 1.7508 ; 4 - du = 2.249 and 4 - dl = 2.434. Because the Durbin-Watson (DW) value is 1.901 greater than the limit (du) 1.7508 and Durbin-Watson (DW) is less than 2.249, it can be concluded that Durbin Watson (DW) test cannot reject H0 which states that there is no positive or negative autocorrelation or it can be concluded that there is no autocorrelation.

Heteroscedasticity test aims to test whether the regression model has a similarity in residual variance, one observation to another observation. The Heteroscedasticity Test results are presented in the following table:

| Variable | Sig. 2 Tailed |
|----------|---------------|
| KM       | .269          |
| KI       | .863          |
| LEV      | .434          |
| CS       | .200          |
| Constant | .097          |
The Heteroscedasticity Test results in the table show the significance values of the four independent variables, more than 0.05. Thus it can be concluded that there is no problem of heteroscedasticity in the regression model.

The normality test aims to determine whether in a residual regression model, the independent variables and dependent variables have a normal distribution or not.

**Table 6**

| Item                  | N  | Asymp. Sig (2 Tailed) |
|-----------------------|----|-----------------------|
| Unstandardized Residual | 90 | 0.200                |

The significant value for Kolmogorov-Smirnov must be above 0.05 or 5%. The sample results in Table 4.6 show that the Kolmogorov-Smirnov value is 0.200 > 0.05 so that the residuals are declared to be normally distributed.

**Table 7**

**Determination Coefficient Test Result**

| Predictor                                                                 | Adjusted R-Square |
|---------------------------------------------------------------------------|-------------------|
| Managerial ownership, Institutional Ownership, Leverage, Company Size to Earning Management | 0.198             |

Based on the table 7 above, it is known that the coefficient of determination seen from the value of Adj R² is 0.198. That is, 19.8% of the variation of the dependent variable earning management can be explained by independent variables (Managerial ownership, Institutional Ownership, Leverage, and Company Size) while the remaining 80.2% (100%-19.8%) is explained by other variables not included in the equation.

**Table 8**

**Simultaneous Significant Test (F-Test) Result**

| Model                                                                 | F     | Sig.  |
|-----------------------------------------------------------------------|-------|-------|
| Dependent: Earning Management                                          |       |       |
| Predictor Managerial ownership, Institutional Ownership, Leverage, Company Size to Earning Management | Regression | 6.508 | 0.000 |

*Support statistically on alpha 5%

**Table 9**

**Significant Test of Individual Parameters (t-Test) Result**

| Unstandardized | Coefficients | Beta | Sig. (One Tail) | Hypothesis |
|----------------|--------------|------|-----------------|------------|
| (Constant)     | -.182        | -.182| .428            | Ha Rejected|
| KM             | 4.923        | .795 | .000            | Ha Rejected|
| KI             | -.795        | .795 | .214            | Ha Rejected|
| LEV            | -.957        | .957 | .170            | Ha Rejected|
| CS             | .375         | .375 | .354            | Ha Rejected|
RESULT AND DISCUSSION

Table 9 shows that the significance of managerial ownership is 0.000<0.05 with a coefficient value of 4.923, so that the decision is H₁ does not been accepted. It can be concluded that managerial ownership has a positive effect on earning management. But the positive significant coefficient reflected that greater ownership would provide managers with deeper entrenchment and, therefore, greater scope for opportunistic behavior (Morck, Shleifer, & Vishny, 1988), which increase earnings management.

The significance value of institutional ownership is 0.214>0.05 with a coefficient value of -0.795 that the decision is H₂ rejected. It can be concluded that institutional ownership does not affect earnings management. Institutional ownership has no effect on earnings management. Indicating that there are many or at least the voting rights owned by the institution cannot influence the size of the profit management carried out by management. The results of this study are in line with Ujiyantho dan Pramuka, (2007). In addition, the views or concepts of Porter (in Midiastuty & Machfoedz, 2003) also say that institutional ownership is the owner who focuses more on current earnings.

The significance value of Leverage is 0.170>0.05 with a coefficient value of -0.957, so that the Hypothesis 3 is rejected. It can be concluded that leverage does not affect on earning management. Indicating that the level of leverage owed by the company does not affect the level of earnings management carried out by management. The results of this study are contrary to the results of research by Widaningdyah (2001) which explains that the higher the level of corporate leverage will make the earnings management motivation for the board of directors increasingly high.

The significance value of Company Size is 0.354>0.05 with a coefficient value of 0.357, so that the Hypothesis 4 is rejected. It can be concluded that the Company Size does not affect earnings management. The influence of company size on earnings management shows that the motivation of the board of directors to do earnings management is not based on company size (Sosiawan, 2012).

CONCLUSION

From this research, the results of the study shows that managerial ownership does not have a negative effect but contrarily, it has a positive effect on earnings management. The results of the study indicate that institutional ownership, leverage is proved to have a negative effect on earning management.

Further research for the suggestion, use the method of calculating financial ratios with other formulas, increase the number of independent variables and multiply the sample not only in variables, firm size, and leverage on earnings management practices in property but also other types companies.

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