Effect of the Independent Board of Commissioners, Audit Committee, Firm Size and Leverage to Earnings Management

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Abstract: Earnings management is the ability to manipulate available choices and make the right choices to achieve the expected level of profit. The purpose of this study was to examine and analyze the influence of independent commissioners, audit committees, company size, and leverage on earnings management in real estate and property sector companies listed on the Indonesia Stock Exchange. This study uses a type of quantitative research by conducting hypothesis testing. The research sample is a real estate and property sector company that was listed on the Indonesia Stock Exchange in 2013-2016 which amounted to 22 companies. The analytical tool used in this study is multiple linear regression analysis. Based on the existing criteria, a sample of 22 companies was analyzed. This study uses multiple linear regression methods. The results of the study show that independent board of commissioners and leverage have a positive and significant effect on earnings management, while the audit committee has no effect on earnings management and firm size has a negative effect on earnings management.

Keywords: Independent Board of Commissioners, Audit Committee, Firm Size, Leverage, Earning Management

1. Introduction

A company is established with the aim of gaining or profit. Gain or profit is needed by the company to sustain the life of the company. Profit is an indicator to measure performance at the management’s responsibility in achieving predetermined operating objectives and helps the owner to estimate the company's ability in the future. Earnings information is often a target of engineering through management's personal actions to maximize it by selecting certain accounting policies, so that profits can be adjusted, increased or lowered as desired. (Sutikno et al, 2014).

The manager is responsible for providing information about the condition of the company to the owner for the management of the company. However, the information submitted is sometimes accepted not in accordance with the actual condition of the company. This condition is known as information asymmetry that can provide opportunities for managers to manipulate profits. It is this information asymmetry which then triggers the emergence of earnings management practices in the company. Good Corporate Governance (GCG) is one of the pillars of the market economy system. The implementation of GCG encourages the creation of healthy competition and a conducive business climate. Therefore, the implementation of GCG by companies in Indonesia is very important to support sustainable economic growth and stability. (Mardhatilla, 2012).

2. Literature Review

Agency Theory

Agency theory describes a relationship that arises because of the contract established between the principal who uses services and agents who carry out various interests. In order for contractual relations to work properly, the principal will delegate authority in making decisions to the agent. (Jensen and Meckling, 1976)

Agency theory in practice raises agency problems, this agency problem arises because of the disparity of interest between shareholders as owners of companies and management as agents. The owner has an interest so that the funds he has invested provide maximum income. While management has an interest in obtaining incentives for the management of corporate funds (Surya et al, 2006: 3). This conflict of interest raises costs which are referred to as agency costs.

The emergence of earnings management can be explained in agency theory. This can be seen by the fact that the manager as the company's operational executor has more internal information than the shareholders. Mastery of this information increasingly motivates managers to act creatively to maximize their personal benefits. This does not rule out the possibility of opportunistic behavior, namely the behavior of managers who do not always act in the interests of shareholders. In maximizing his personal benefits, managers will certainly try to show better performance so that the motivation of managers to practice earnings management will also be stronger (Sulistiawan et al, 2011: 31).

Earnings Management

Wolk et al (2001) suggested that earnings management is an intervention in the external financial reporting process with the intention of obtaining personal benefits. Whereas according to Scott (2003: 377) the way of understanding earnings management becomes two, namely seeing it as opportunistic behavior of managers (opportunistic earnings management) and looking at earnings management from the
perspective of the efficient contracting (Efficient Earnings Management). The motivation of management to carry out profit management actions is as follows:

1) Hypothesis Bonus Plan
2) Debt Covenant Hypothesis
3) Political Cost Hypothesis

Government regulations in the form of taxation based on profits earned by the company will encourage management to conduct earnings management by reducing the rate of profit to reduce the tax obligations that must be paid by the company.

Good Corporate Governance

Some of the mechanisms of Good Corporate Governance are, among others, realized by the existence of independent commissioners and audit committees:

a) Independent Board of Commissioners.

Board committees consist of executive directors (internal directors) and non-executive directors (outside directors including independent non-executives). The role of the independent non-executive director is to bring independent judgment to the Board. The need for an independent non-executive director is to provide check-and-balance for the activities of the executive directors. Independent non-executive directors should monitor management activities on behalf of shareholders. (Yang et al, 2009: 3). The existence of an independent board of commissioners is expected to minimize the practice of earnings management because the independent board of commissioners functions as a divider of interests between shareholders and management. (Oktaviani, 2016: 3). Independent commissioners function as advisors who provide advice, opinions, and input in order to achieve company goals. The main tasks of this independent commissioner include assessing and directing the company's strategy, risk control policies, annual budgets, and business plans; assess the system for determining the remuneration of officials holding key positions; monitor and resolve conflicts of interest; and monitor the process of openness and effectiveness of communication within the company (Warsono et al, 2010).

b) Audit Committee

The audit committee is the operating committee of the board of directors responsible for overseeing financial disclosures and reporting. The committee member is taken from the board of directors of the company board, with a chairman chosen from among the committee members. The audit committee has a very important role to play in relation to fraud and oversees the risk of management fraud. In this case, the audit committee plays an important role in preventing, detecting and investigating fraud and earnings management. As far as fraud and earnings management are concerned, the audit committee must have a decision without tolerance and all such examples must be taken with facts. (Uadiale, 2012: 5). Independent audit committee members will ensure better quality financial reporting (Prastiti et al, 2013: 3).

Firm Size

Firm size is a characteristic of the company in relation to the structure of the company, Firm size can describe the size of the company as indicated by total assets, sales, and market capitalization. The greater the total assets, sales, and market capitalization, the greater the size of a company. The bigger the asset, the greater the capital invested, the more sales, the more money will be circulated and the greater the market capitalization. Of these three variables, total asset variables are often used in measuring company size because asset values are relatively more stable compared to sales and market capitalization. (Sutikno et al., 2014: 5). Linasmi (2017: 3) states that company size becomes a benchmark for company size by looking at the value of equity, the selling value or the total value of assets owned by the company. Company size is a scale that can be classified by large companies in various ways, including: total assets, log size, market value, and others. Firm size is often used as an indicator for the possibility of bankruptcy for a company. This is because companies with a larger size are considered more able to deal with a crisis in running their business. The size of the company will affect the structure of corporate funding. Companies tend to need more funds than smaller companies. Additional funds can be obtained from the issuance of new shares or additional debt. (Astuti et al, 2017: 3).

Leverage

Another variable that influences earnings management is leverage. The greater the company's debt, the greater the risk for the owner so that the owner will ask the higher level of profit that the company is not threatened with liquidation. Companies that have high leverage ratios tend to manipulate earnings management. (Wiyadi et al, 2015: 2). This ratio shows the proportion of "other people's money" compared to the total claims against company assets. The higher the ratio, the greater the risk for the lender. But this ratio does not have to be a true indication of the company's ability to pay its debts. (Helfert, 1997). Leverage is a ratio used to assess how much assets a company is financed by using debt. Companies with more assets financed by debt tend to take action to increase the amount of profits earned due to the high interest expense. (Rice, 2016: 2). In a broad sense it is said that solvency ratios are used to measure a company's ability to pay all its obligations, both short and long term if the company is dissolved (liquidated).

3. Design Research

Research Object and Time Research

This research was conducted in 2018, namely by taking company data on real estate and property sectors listed on the Indonesia Stock Exchange in the period of 2013-2016 from www.idx.co.id and the company's website. The objects of this study include earnings management, independent board of commissioners, audit committees, firm size and leverage.

Population and Sample Research

This study aims to test hypotheses, namely testing the effect of independent variables (independent board of
commissioners, audit committee, firm size and leverage) on the dependent variable (earnings management). The sample method that will be used in this study is the purposive sampling method which is a sampling technique by selecting data sources based on predetermined criteria. This type of research is quantitative carried out by analysis of hypothesis testing by testing hypotheses on all the variables studied. The research time horizon is cross-sectional because data is collected once during the annual period. The type of data used is secondary data obtained from annual financial reports. Data obtained from the Indonesia Stock Exchange.

The regression equation above contains that:

a) Effect of the number of independent commissioners on earnings management

Based on table 4.3 shows the independent commissioner variable obtained a regression coefficient positive value 0.147. The value of t count is 2.372 and the probability value is 0.020 (0.020 < 0.05). Thus, the hypothesis of the number of independent commissioners can be accepted or supported because the number of independent commissioners has a positive and significant effect on earnings management.

b) Effect of the number of audit committees on earnings management

Based on table 4.3 shows the audit committee variables obtain a regression coefficient positive value 0.014. The value of t count is 0.102 and the probability value is 0.020 (0.919> 0.05). Thus, the hypothesis of the number of audit committees is not supported because the number of audit committees has no effect and is not significant on earnings management.

c) Effect of company size on earnings management

Based on table 4.3 shows the variable size of the company obtained a regression coefficient negative value -0.020. The value of t count is -2.840 and the probability value is 0.006 (0.006 < 0.05). Thus, the company size hypothesis is supported because the size of the company has a negative and significant effect on earnings management.

d) Effect of leverage on earnings management

Based on table 4.3 shows the leverage variable obtained a regression coefficient positive value 0.210. The value of t count is 5.701 and the probability value is 0.000 (0.000 < 0.05). Thus, the leverage hypothesis is supported because leverage has a positive and significant effect on earnings management.

4. Conclusion

The test results and discussion in the previous section can be summarized as follows:

1) Independent commissioners have a positive and significant effect on earnings management. This shows that more and more independent commissioners will increase the value of earnings management.

2) The audit committee has no effect on earnings management. This shows that the existence of the audit committee is only to fulfill the requirements proposed by the government. With the establishment of an audit committee as fulfillment of the regulations or conditions, the duties and functions of each element become unclear or unclear so that the existence of an audit committee is less effective in monitoring management performance and in the aspects of corporate control.

3) Company size has a negative effect on earnings management. This shows that large companies will be more careful in conducting financial reporting and tend to report financial conditions accurately because they are more concerned by the public. While small companies have a tendency to do earnings management by reporting
greater profits so that they can show better company performance.

4) Leverage has a positive and significant effect on earnings management. This shows that high leverage shows that the risks faced by investors are getting higher so investors will ask for greater profits; this motivates managers to do earnings management.

References


