

# Is the Implementation of Good Corporate Governance Able to Improve Earnings Quality

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## ABSTRACT

The purpose of this research is to analysis the effect of implementing good corporate governance on quality information of earnings. The population of this study is all non-financial firm that are included in the fast-growing company. We found in this study that board structure and process have a positive contribution on quality of earnings information. Ownership control and characteristics negatively affect on quality of earnings information. Size of the firm has a positive influence on earnings quality. Firm size affects the relationship of good corporate governance to earnings quality.

**Keywords:** good corporate governance, earnings quality, firm size.

## 1. INTRODUCTION

Quality of earnings information largely determines the accuracy of decision making. Earnings management is a form of presentation of financial information that is not in accordance with the reality of achievements of the firm. Schipper in Subramanyam and Wild [1], reveals that earnings management is a deliberate interference of management in the process of determining earnings to meet personal goals. Earnings Management made by companies can cause earning that it is reported that the company is not qualified, which is done to give a positive signal to the public to get good grades, so as to increase the value of the firm.

The reliability and integrity of financial information can be maximized by monitoring mechanisms within the firm through Good Corporate Governance [1]. Several studies have proven a negative relationship between ownership concentration and earnings quality [2], [3]. On the other hand, Irawati & Sudirman [4] and Morck in Niu [5] stated that the more concentrated the ownership, the better the firm's earning quality. While research conducted by Natalia & Laksono [6] state that

ownership of the management has no effect on quality of earnings information.

Abbadi, et. al. [7] state that the implementation of the board characteristics will improve the quality of corporate earnings information. Taktak and Mbarki [8] also have the same opinion that board characteristics can minimize managerial cheating through earnings management practices. In contrast to three previous studies by Chiang, et al. [9], and Oktaviani, et al. [3] stated that the board of directors had no effect on quality of earnings information.

## 2. METHODS

The population of this study was 40 non-financial and non state-owned companies that were nominated for "100 fastest growing companies" for 2016-2018 which selected by the Infobank Research Bureau.

Sample were selected purposively to produce 19 companies that have the appropriate criteria. Observation were made for 6 years resulting in a total of 114 observational data.

**Table 1** Samples Selection

Criteria	Samples Criteria	Amount
1.	Companies that including the ranks of the 100 fastest growing companies and nominees during 2016-2018 (39 companies were the 100 fastest growing companies and 1 nominee company)	40
2.	The company provided a complete financial report during 2012-2017	35
3.	Companies that disclose GCG in the annual report for 2012-2017	35
4	Outlier	16
	Final Research Sample	19

The data used in this study were collected and sourced from the official site of the Indonesia Stock Exchange. Data also gained from the official website of the firm to obtain minutes of the results of the General Meeting of Shareholders (GMS) and annual reports, and Infobank's Official Website (www.infobank).

### 3. RESULT AND DISCUSSION

The results of statistical analysis for model 1 can be shown in the table 2 below.

**Table 2** Results of Multiple Regression Test Models 1

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error			
1	(Constant)	-.068	.235		-.289	.773
	BOARD	-.454	.167	-.246	2.722	.008
	OWN	.675	.336	.181	2.007	.047

a. Dependent Variable: ERQUAL

(Sources: Data Processed)

As per table 2 above, the regression equation model from the estimation results of multiple linear regression analysis by looking at the unstandardized coefficients column is as follows:

$$Y = -0.68 - 0.454 \text{ BOARD} + 0.675 \text{ OWN} + e$$

Hypothesis test results from the regression equation of the research model 1 above show that the board

significantly influences discretionary accruals and directly influences the quality of the company's earnings. OWN has a significant influence on discretionary accruals and directly affects the quality of the company's earnings.

Table 3 shows the results of the multiple regression analysis for the research model 2.

**Table 3** Results of Multiple Regression Test for Models 2

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error			
1	(Constant)	1.217	.466		2.608	.010
	BOARD	-.180	.183	-.097	-.984	.327
	OWN	.586	.325	.157	1.804	.074
	SIZE	-.090	.029	-.312	-3.147	.002

a. Dependent Variable: ERQUAL

Table 3 above illustrate the regression equation model from the estimation results of statistical analysis as equation below.

$$Y = 1,217 - 0.180 \text{ BOARD} + 0.586 \text{ OWN} - 0.090 \text{ Size} + e$$

Based on the regression equation above and partial hypothesis testing, it can be seen that there is no significant effect of the board variable on the earnings quality variable represented by DA. There is no significant effect of the OWN variable on the earnings quality variable represented by DA. Size significantly influences discretionary accruals and directly affects earnings quality. In this case, the size of a company significantly influences the quality of the company's earnings.

#### 3.1.The Influence of Board Structure and Process (BOARD) on the Earnings Quality

The results of the research model 1 show that BOARD has a negative effect on discretionary accruals that will indicate whether or not the quality of a profit reported by the company. While the research model 2 after entering the variable size shows that BOARD has not significantly to discretionary accruals. The results of this

study are in consistent with research by Abbadi et al. [7].

The board meeting, which in this study contained the board of commissioners meeting. In addition, there are indicators of the structure and implementation of the audit committee (audit committee reputation) which consist of audit committee existence (disclosure of profile and permanent committee audit), the frequency of audit committee meetings, the ability of the audit committee, and the reputation of the audit committee. The results are consistent with research findings by Nazir & Afza [10] and Grassa [11].

In the results of model 2 shows that the BOARD has no relationship with earnings quality after entering the variable size, this shows that the size of a company have influence the relationship between BOARD and information of earnings quality. In this study, small companies tend to have high BOARD scores, so if a variable size is included, then there will be no significant effect on discretionary accruals which indicate the earnings quality of the company. This is consistent with research conducted by Natalia & Laksono [6] who conducted research on corporate governance mechanisms in this case the board structure of earnings management practices calculated using the Modified Jones' Model 1991 in the burdened business sector for the 2008-2011 period with the result that the board structure (board size, independent commissioner) has no influence on discretionary accruals. According to Natalia & Laksono [6] in the implementation of company operations, the existence of independent commissioners was less effective because of the possibility that the average banking sector business entity listed on the Indonesia Stock Exchange (IDX) of 2008-2011 appointed independent commissioners only to fulfill regulations. In addition, the results of this research are also consistent with Hoang, et. al. [12] that BOARD has no effect on information of earnings quality. According to Hoang, et al. [12] BOARD has no effect, among others, because the independent commissioners are part-time bodies so that they meet only occasionally and each does not know each other well. So that it is possible that the commissioner boards doesn't have the right time to thoroughly comprehend the business and company issues, management allows to obscure the problem. In addition, audit quality included in the BOARD indicator is ignored by the company because the company only wishes to improve the

company's performance so that it is good in the eyes of investors and ignores the existence of the big four KAP, so that good BOARD implementation does not have a significant effect on the reported earnings quality of the company in financial statements.

### *3.2. The Effect of Ownership and Control Characteristics (OWN) on the Earnings Quality.*

Based on the results of the regression analysis of models 1 and 2, OWN achieves on the earnings quality of the company have inconsistent results. The results of research model 1 show that the OWN variable has a significant positive effect on discretionary accruals. While the results of research model 2 show that OWN has not significant effect on discretionary accruals. The indicators in this study are the magnitude of controlling ownership, managerial ownership, and institutional ownership. The results of research model 1 means that the greater the OWN score, the greater the value of discretionary accruals or when the company's shares are widely owned by management and institutions, the greater the chance for management to intervene in the determination of earnings which results in higher discretionary accruals, causing earnings quality has declined. These results are consistent with Irawati & Sudirman [4].

The concentration of ownership which according to Asward and Lina [13] can be an internal mechanism for disciplining management and being an effective oversight in this study failed to be as expressed by Asward and Lina [13]. In addition, greater management and institutional ownership that is expected to reduce agency conflict and moral hazard in this study fails. Mellado & Saona [2] also gives the opinion that controlling owners will provide financial statement information for personal purposes, and concentrated ownership will indicate the low quality of financial information. Sulistiawan, et al. [14] revealed that in reference to corporate fraud, there is the term triangle that causes fraud (fraud triangle) which consists of opportunity, pressure, and rationalization. If seen from the analysis of this results that OWN has negatively effect on profitability, the fraud triangle that is suitable for this translation is an opportunity Sulistiawan, et al. [14] and Mellado & Saona [2]

The results of research model 2 show that the own variable has no effect on earnings quality. That is, the size of the shareholding score will not affect the motivation of company managers to intervene in determining company profits. This result is supported by research conducted by Okaviani, et al. [3].

### *3.3. Effect of Firm Size on the Earnings Quality*

Based on the regression analysis of research model 2, the results show that size has a negative and significant effect on discretionary accruals. These results mean that the larger the size of the company, the better reported earnings quality. The results of this study are in line with research conducted by Dira & Astika [15].

In addition, other research conducted, the researchers states that politically large-scale companies will be more likely to carry out political cost transfers in the framework of political processes compared to small-scale companies [16]. The impact of this political process is the choice of better accounting procedures by large companies. Another study conducted by Lys, et al. [17] that signaling theory predicts a positive influence between company size and the integrity of financial reporting. Large-scale companies are more reliable when reporting financial information to get a positive signal in the public eye. Large-scale companies get more public attention, so when it comes to cheating large-scale companies are likely to think about the impact that occurs that is broad public confidence in the company. Besides being in line with some of the studies above, this result is also in line with research conducted by Abbadi, et al. [7].

### *3.4. Effect of Firm Size in the Relationship between Board Structure and Process (BOARD) and Ownership and Control Characteristics (OWN) on Earnings Quality*

The results of the analysis of models 1 and 2 show inconsistent results. In research model 2 after adding the size variable, it shows no significant effect between BOARD variable on earnings quality and OWN variable on earnings quality. The inconsistency of these results shows that, variable size affects the relationship between BOARD and OWN on earnings quality becomes meaningless.

The firm size that affects the relationship between board structure and process and ownership control and characteristics shows that as size increases, or the larger the size of a company, the ideal fulfillment of the implementation of good corporate governance will be better. In this case the implementation of board structure and process and ownership control and characteristics. However, in this study the implementation of good corporate governance tends to be stagnant in the board structure and process section and has decreased in the ownership control and characteristics section as the size of the company is represented by the total assets of the company. The majority of fast-growing companies (2016-2018) experienced an increase in high GCG values in 2013-2015. This Board Score tends to be unchanged in most companies because companies tend to use the same rules every year. The regulation is adjusted to the new government regulation. The most influential regulation is the composition of the board of commissioners. The majority of fast-growing companies (2016-2018) only use the minimum limit of the provisions of the members of the commissioners that have been set by the government, which is a minimum of 30%. In fact, ideally the larger the size of a company, the company should be able to meet more than the minimum requirements, so that in this case the accountability of independent commissioners is ignored and the results of hypothesis testing in the research model 1 that is the influence of the board on the company's profit quality becomes less meaningful with this size. In addition, there are other factors that make the board less meaningful, an increase in other sub-indicators, in this case an increase in the implementation of the sub-committee committee under the independent commissioner namely the audit committee and the remuneration committee. The bigger the company, the implementation of the assistant committee of the board of commissioners tends to get better. This makes the board score stagnant (no significant change) from year to year and makes the board relationship and earnings quality meaningless.

## **4. CONCLUSION**

Based on the results above, it can be concluded that board structure and process has a significant positive effect on the quality of fast-growing company earnings. Ownership control and characteristics have a significant negative effect on earnings quality. Size has a significant

positive effect on earnings quality. Size affects the relationship of good corporate governance to earnings quality

Based on the above conclusions, the researchers offer a number of suggestions, including: 1) it is better if the companies that fall into the category of fastest growing companies for 3 years in a row namely 2016-2018 to improve the implementation of good corporate governance (GCG), especially on board structure variables and process; 2) investors should carefully select the company. Companies that have many awards may not necessarily have quality earnings for future company performance predictions; 3) variables of this research are still not able to define the variation of variables that affect earnings quality, so further researchers can also develop research by making variable size a moderating variable in the relationship of good corporate governance to earnings quality. Future researchers should only focus on certain sectors in conducting research like this. This research uses too much the corporate sector but is not supported by the number of companies in one sector.

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