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Corporate Governance, Corporate Social Responsibility Disclosure and Earnings Management

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Abstract **–The aim of this study is to examine the influence of corporate governance and corporate social responsibility disclosure on earnings management practice. Corporate governance measured by board of director, independent board and institutional ownership. The population in this study consist of non-financial firm that listed in Indonesia Stock Exchange from 2014-2016 and the sample are 94 non-financial firms. Sampling method used is purposive sampling and to test the hypothesis using a multiple regression. The result of this study show that corporate governance do not have influence on earnings management and corporate social reporting disclosure negatively influence on earnings management. The social responsibility activities on the annual report will make financial information more reliable for those who used the financial statements. Companies that reveal more information about their company's activities will be more restrictive to earnings management practices.**

Keywords–earnings management; corporate governance; corporate social responsibility

I. Introduction

Nowadays the financial information is no longer the main thing for investors to invest in the companies, with the existence of non-financial information then the decision of investors to invest in the company is now based on financial and non-financial information. Financial information obtained through financial statements and non-financial information can be obtained through CSR (Corporate Social Responsibility), which in this CSR includes information on employees, consumers, communities and the environment. Financial information is not the main thing in the decision to invest because of the management intervention in the financial information, so that non-financial information needed to support the decision to invest in the companies. In Indonesia, CSR reporting has started to grow, with the government regulation stipulated in Government Regulation no. 47 of 2012 on social and environmental responsibility of limited companies and limited company law (UUPT) is expected to be more transparent and can reduce earnings management practice. In addition a mechanism that can be used to mitigate earnings management practices are the corporate governance. This mechanism include independent board of commissioners, institutional ownership and others that can monitoring the management. Indonesia has a high level of earnings management compared to other developing countries in Asia [1] and with corporate governance and CSR disclosure is expected to suppress earnings management practices. This is the motivation in doing this research.

The questions in this research are: (1) whether corporate social responsibility disclosure a negative effect on earnings management, (2) whether board of director a negative effect on earnings management, (3) whether independent board a negative effect on earnings management, (4) whether institutional ownership a negative effect on earnings management. This study aims to develop and test the effect of corporate social responsibility disclosure to earnings management and corporate governance on earnings management. The study was conducted over a three-year period in 2014 to 2016.

A. Theoretical Framework

1) Agency theory: In agency theory, the parties involved are acting as an agent is the management and investor who acts as a principal. Neither the agent nor the principal has things that must be improved and there is no reason to believe that the agent will always act in the interests of the principal. In the state of principal and agent have each other's interests, it will cause distrust that the agent will always act in the interests of the principal. Problems arising from agency theory is to make the agent acts to improve the welfare of the principal not their own welfare [2].

2) Stakeholder theory: In stakeholder theory explains that a company is not an entity that operates only for its own sake. However, the entity must also be able to provide benefits to its stakeholders such as shareholders, creditors, consumers, suppliers, governments, communities, analysts, and others [3]. Each stakeholders has different interests that can lead to conflict between the parties. Therefore the companies have a responsibility to manage a business in that balances interests among all stakeholder using financial information and non-financial information [4].

II. Method

The World Business Council for Sustainability Development (WBCSD) defines corporate social responsibility as an ongoing commitment of business people to behave ethically and contribute to economic development. corporate social responsibility disclosure is a corporate obligation that not only provides goods and services to the community, but also contributes to the well-being of the communities in which they operate [5]. Corporate social responsibility is realized in order to maintain a balance between business and surrounding so that all parties will not be harmed [6]. Corporate social responsibility has an important role for the company. This is because the company operates in a community environment and its activities may have social and environmental impacts. In the end, corporate social responsibility disclosure is a managerial tool that companies use to avoid social and environmental conflicts and corporate social responsibility disclosure can also create support from stakeholders for companies due to transparency in their reporting [3]. Corporate social responsibility reporting have negative effect on earnings management. The asymmetry of information is reduced because the publication of information with regard to the responsible behavior of companies [7-10]. This behavior then, allows a change in downwards earnings management [7]. The more information about responsibility of companies, lower earnings management practices. Hypotheses are constructed are as follows:

Ha1: Corporate responsibility reporting negatively effect on earnings management.

In this study the board of directors is board of commissioners. The board of commissioners within the company is an important organ in the supervision of the board of directors. In IDX regulations that the duty of the board of commissioners is for the supervision of management thereby reducing the intention to make earnings management reduced. The board of commissioners negatively affects earnings management, due to the supervisory level of the commissioners who suppress earnings management practices by management [11-15]. Hypotheses are constructed are as follows:

Ha2: Board of director negatively effect on earnings management.

In IDX regulations, it is stated that the listed company must have an independent commissioner not affiliated with the company and the amount is at least 30% of the total board of commissioners. With the existence of independent commissioners will further strengthen the supervision of the board of commissioners because it is not affiliated with the company. The independent board of commissioners negatively affects earnings management [13,15,16]. Hypotheses are constructed are as follows:

H_{a3}: Independent Board negatively effect on earnings management.

Institutional ownership is the ownership of a company's stock from an institution. As is ownership within the company, institutional investors will have the power to be responsible for implementing the principles of Corporate Governance intended to protect the rights and interests of all shareholders [17]. So with greater institutional ownership, the implementation of corporate governance will increase and the practice of earnings management will decrease. Institutional ownership negatively affects earnings management [18-21]. Hypotheses are constructed are as follows:

Ha4: Intitutional ownership negatively effect on earnings management.

Earnings management is measured using a modified model of Jones, corporate governance is measured using, board of director, independent board and institutional ownership quality. The analysis tool used is multiple regression analysis. Modified Jones Model used in the study [22] became the model used in this study

$$TACCit = NIit - OCFit \quad (1)$$

TACCit = Total Accruals for company I in year T
NIit = Net Income before extraordinary items for company I in year T
OCFit = Operating Cash In Flow for company I in year T

$$TACCit / Ait\text{-}1 = \alpha 1(1/Ait\text{-}1) + \alpha 2(\triangle REVit - \triangle RECit)/Ait\text{-}1 + \alpha 3(PPEit/ Ait\text{-}1) + e \quad (2)$$

TACCit = Total Accruals for company I in year T
Ait-1 = Lagged Total Asset for company I
$\triangle$REVit = *Changes in Operating Revenue for company I in year T*
$\triangle$RECit = *Changes in Net Receivables for company I in year T*
PPEit = *Gross Property, Plant and Equipment for company I in year T*
α1-α3 = *Regression Parameters*
e = error term

$$NDTACCit / Ait\text{-}1 = \hat{a}1(1/Ait\text{-}1) + \hat{a}\,2(\triangle REVit - \triangle RECit) + \hat{a}\,3(PPEit) + e \quad (3)$$

NDTACCit= Non-Discretionary Accruals for company I in year T
Ait-1 = Lagged Total Asset for company I
$\triangle$REVit = *Changes in Operating Revenue for company I in year T*
$\triangle$RECit = *Changes in Net Receivables for company I in year T*
PPEit = *Gross Property, Plant and Equipment for company I in year T*
â1- â3 = *Regression Parameters*
e = error term

$$DACCit = TACCit - NDTACCit \quad (4)$$

DACCit = Discretionary Accruals for company I in year T
TACCit = Total Accruals for company I in year T
NDTACCit= Non-Discretionary Accruals for company I in year T

Disclosure of corporate social responsibility is measured by an index as used by Dewi [23]. The board of measure is measured by the number of commissioners in the company, independent board is measured by the percentage of independent commissioners in the company. Institutional ownership is measured by the percentage of institutional ownership which includes banks, pension funds, insurance companies, limited liability companies and other financial institutions. In this research. In this research model also included some control variables. Size of the company negatively affect earnings management [24-26].

Company size measured by the natural logarithm of the total assets owned by the company. Leverage is positive effect on earnings management [27]. In this case a higher leverage, the greater the opportunity to perform management earnings management practices. Leverage is measured by comparing the total debt and total equity owned by the company. The next control variable is the growth in sales. Sales growth had a negative influence on the decision to undertake earnings management [26]. The sales growth is measured by the percentage growth in sales each year. The population used in this study are all companies listed in Indonesia Stock Exchange (BEI). The study period is three years from 2014-2016. This study using purposive sampling technique that aims to obtain a representative sample in accordance with the specified criteria.

III. Results and Discussion

In this study, the population data used are non-financial companies listed on the Indonesian Stock Exchange (BEI) in 2014-2106. Total sample of companies that could be gathered in this study were 94 companies in accordance with predetermined criteria. Table 1 shows the sample determination procedures are carried out.

TABLE I. SAMPLE SELECTION PROCEDURES

Description	Number of companies	Number of data
Non-financial companies that are consistently listed on the Indonesia Stock Exchange during the 2014-2016 period	406	1218
Non-financial companies that do not issue annual reports and financial statements for the period 2014-2016	55	165
Non-financial companies that do not present financial statements that ended on December 31 during the 2014-2016 period	20	60
Non-financial companies that do not present financial statements in Rupiah currency for the period 2014-2016	80	240
Non-financial companies that do not have a positive profit during the 2014-2016 period	120	360
Non-financial companies that do not have a positive profit during the 2014-2016 period	39	117
Total	92	276

Based on table 2, it can be seen that the disclosure of corporate social disclosure in companies that are sampled have not all expressed them in the annual report, seen from the average disclosure value of only 17%. Independent commissioner variable, the average company meets the criteria for the number of independent commissioners, which is more than 30%.

TABLE II. DESCRIPTIVE STATISTIC

	Max	Min	Mean	Std. Dev
EM	2.872000	0.000000	0.074172	0.184892
CSRD	0.500000	0.012821	0.175077	0.085527
BOD	22.00000	2.000000	4.000000	2.527307
IND	1.000000	0.125000	0.369318	0.108882
IO	0.989700	0.070700	0.651881	0.207619
SIZE	33.19881	24.56831	28.69575	1.699375
ROA	2.988333	0,000665	0.090595	0.189064
LEV	5.200436	0.073786	1.009546	0.869824
GROWTH	1.155364	-0.884422	0.060417	0.216507

From table 3, shows that corporate social responsibility negatively affect earnings management. CSR can reduce the earnings management because asymmetry of information is reduced because the publication of information with regard to the responsible behavior of companies. This behavior then, allows a change in downwards earnings management [7]. The more information about responsibility of companies, lower earnings management practices [7-10]. Independence board also negatively affect earnings management. With the existence of independent commissioners will further strengthen the supervision of the board of commissioners because it is not affiliated with the company and will reduce earnings management [13,15,16].

TABLE III. HYPOTHESIS TEST RESULT

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.197856	0.109463	1.807524	0.0718
CSRD	-0.212919	0.072819	-2.923958	0.0037
BOD	0.001552	0.002373	0.654268	0.5135
IND	-0.105052	0.052611	-1.996788	0.0468
IO	-0.011844	0.027150	-0.436239	0.6630
SIZE	-0.005042	0.003969	-1.270488	0.2050
ROA	0.831378	0.028786	28.88175	0.0000
LEV	0.026857	0.006438	4.171505	0.0000
GROWTH	-0.017794	0.025275	-0.704033	0.4820
R-squared	0.768320	Mean dependent var		0.074172
Adjusted R-squared	0.761531	S.D. dependent var		0.184892
S.E. of regression	0.090289	Akaike info criterion		-1.940206
Sum squared resid	2.225529	Schwarz criterion		-1.823974
Log likelihood	282.5690	Hannan-Quinn criter.		-1.893596
F-statistic	113.1686	Durbin-Watson stat		1.913430

IV. Conclusions

Based on test results that have been done, it can be drawn some conclusions as follows:

Corporate social responsibility negatively affect earnings management. CSR can reduce the earnings management because asymmetry of information is reduced because the publication of information with regard to the responsible behavior of companies. This behavior then, allows a change in downwards earnings management [7]. The more information about responsibility of companies, lower earnings management practices [7-10]. Independence board also negatively affect earnings management. With the existence of independent commissioners will further strengthen the supervision of the board of commissioners because it is not affiliated with the company and will reduce earnings management [13,15,16]. Board of director and institutional ownership do not affect the earnings management. In this research there are some limitation, in this research do not use GRI 4 to calculate CSR and for the next research, CSR can be separate into each category to see which category that affect earnings management.

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