THE INFLUENCE OF INFORMATION ASYMMETRY, INDEPENDENT COMMISSIONER BOARD, AUDIT COMMITTEE, MANAGERIAL OWNERSHIP, AND FIRM SIZE ON EARNINGS MANAGEMENT

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ABSTRACT

This research aims at identifying the influence of information asymmetry, independent commissioner board, audit committee, managerial ownership, and firm size to the earnings management. Information asymmetry measured with relative bid-ask spread; independent commissioner board measured with the percentage of independent commissioner members from the total commissioner board in the company; audit committee measured with dummy variable; managerial ownership measured with the percentage in the share capital owned by the management from the total capital of the company; firm size measured withnatural logarithm of the total assets, and earnings management measured with The Modified Jones Model to calculate the discretionary accrual. This research employs the sample from the manufacture companies listed in Indonesia Stock Exchange of 55 companies. The sampling conducted is purposive sampling technique. This research based on the hypothesis testing using multiple linear analysis method, it can be concluded that partially, the information asymmetry and managerial ownership has significant influence on the earnings management. Meanwhile, simultaneously, it is proved that information asymmetry, independent commissioner board, audit committee, managerial ownership, and firm size has significant influence on the earnings management of the manufacture companies.

Keywords: information asymmetry, independent commissioner board, audit committee, managerial ownership, firm size, earnings management

1. INTRODUCTION

Setiawati and Na'im (2000) define that earnings management is the management intervention in external financial statement reporting process aiming at private gain. However, principally the practices of earnings management do not contradict the generally accepted accounting principles. Yet, these practices can cut the people's trust about the external financial statement and hinder the capability of capital flow in capital market. These practices can also decrease the quality of the company's financial statement. Earnings management also brings disadvantages to the investors since they will not get the right information about the company's financial condition (Scott, 2000). Whenever financial decisions are based on intentional judgment applied for transaction structuring and financial reporting with the sole purpose of meaningful deceit, concealment or data spinning, it gives rise to earnings management. This is done in order to mislead the investors and stakeholders and influence favorable outcomes from business contracts through manipulated accounting (Baig, 2016) .

2. LITERATURE REVIEW

According to Scott (2006), agency theory is a branch of game theory that studies the design of contracts to motivate a rational agent to act on behalf of a principal when the agent's interests would otherwise conflict with those of the principal.

It means that the development of a theory learning about a contract design where the agents work on behalf of the principal when their wants/purposes contradict, then there will be a conflict. The shareholders and the managers have different purposes and each of them wants to fulfill their purposes. As a result, the conflict of interests occurs. The shareholders want bigger and faster return of their investment, while the managers want their interests to be accommodated with compensation or incentive on their performance in running company as much as they can.

Information asymmetry is the condition where the agents have more information about the company and the future prospect than the principal does. Such condition provides opportunity for the agents to use the information that they have in manipulating the financial statement report as their effort to optimize their welfare. Such information asymmetry leads to the moral hazard where the management conducts earnings management (Rahmawati, 2006).

Independent commissioner board commonly consists of commissioner board outside the company and functions to balance the decision-making, particularly in protecting the minor shareholder and related parties. Independent commissioner is the commissioner board that is not affiliated with the management, other commissioner board members, and controlling shareholders, and free from business relationship or other relationship that can affects its ability to act independently or to act for the sake of the company (The National Committee on Governance, 2006).

Audit committee is company component that plays role as company control. Audit committee can also function as the mediator between shareholders as well as commissioner board and the management in terms of controlling the internal company. Audit committee acts to keep the credibility of the financial statement reporting process (Rahmawati, 2007). Nasution and Setiawan (2007) found negative relationship between audit committee and earnings management. This shows that company with audit committee will be more responsible and open in reporting the financial statement and will hinder the earnings management practices since the audit committee will monitor all company activities.

According to Folrackis et all (2009), on one hand, managerial ownership can help align the interests of managers with those of shareholders, by constraining the consumption of perks and the engagement in sub-optimal investment policies (incentivealignment effect). On the other hand, managers tend to exert insufficient effort, collect private benefits and entrench themselves at higher levels of managerial ownership, leading to a negative relationship between managerial ownership and performance (entrenchment effect). Scott (2000) divides the ways to understand earnings management. First, to see the behavior of the managers' opportunity to optimize the utility in facing compensation contract, debt contract, and political costs (opportunistic earnings management). Second, to see the earnings management from the perspective of efficient contracting (efficient earnings management), in which the earnings management provides the managers a flexibility to protect themselves and the company in anticipating the unexpected events for the benefit of the related parties in the contracts. Thus, the managers can influence the share market value of the company using earnings management. Earnings management is an action done by the managers to manipulate the data and accounting information so that the earnings recorded in the financial statement is suitable with the managers' expectations, both for individual interest and company interest.

3. RESEARCH METHOD

Hartono (2008), state that agents are in the position that can get more information about their capacity, work environment and the company thoroughly than the principal does. With the assumption that each individual acts to optimize their own interest, so using the information asymmetry that they own, it can drive the agents to hide some information unidentified by the principal. In such condition, the principal is often in inconvenient position. Dai et. all (2013) investigates how information asymmetry and mutual fund ownership affect listed companies' earnings management. They show that reducing information asymmetry improves firms' earnings management behavior and the information environment significantly increases the effect of long-term mutual funds on firms' earnings management.

From some research above, then the hypothesis for this research is:

H_1: Information asymmetry influences to the earnings management

Independent commissioner functions as the management policy supervisor and advisor for the management that acts as the representative of the company owner. The independent commissioner is the best monitoring tool in supervising the actions and policies taken by the management so that good corporate governance is realized. Xie, et.al (2001) researched on the role of commissioner board with the financial aspect background in preventing the earnings management. The research conducted by Ujiyanto and Bambang (2007) as well as Nasution and Setiawan (2007) states that the composition of independent commissioner board has positive influence on the discretionary accrual variable.

From some research above, then the hypothesis for this research is:

H_2: Independent commissioner board influences to the earnings management

Audit committee is the mediator between the shareholders as well as commissioners board and the management in handling control problems. Audit committee facilitates the commissioner board to conduct supervision to the management in presenting the financial statement ordinarily, control structure of the internal company, internal and external audit implementation, and follow-up to the findings of the audit results conducted by the management.

Klein (2000) found out that earnings management occurs in the companies with audit committee that consists of smaller independent directors members than the majority of the independent directors. Badolato et all (2014) find that audit committee with both financial expertise and high relative status are associated with lower levels of earnings management, as measured by accounting irregularities and abnormal accruals. These results speak to benefits and limitations of financial expertise, which have been the focus of considerable debate. Xie et all. (2001) conclude that the active independent commissioner and audit committee that have knowledge about finance might be a crucial factor in preventing the managers' tendency to do earnings management.

From some research above, then the hypothesis for this research is:

H_3: Audit committee influences to the earnings management

Alessandri and Seth (2014) has examined the effects of managerial share ownership on business diversification, typically from the incentive alignment perspective. Yet, share ownership also shifts risk to managers (the efficient managerial contracting perspective). Furthermore, the effects of managerial ownership on international diversification are unexplored. They examine how managerial ownership influences both international and business diversification in light of the trade-off between incentive alignment and risk bearing. Based on the differing risk profiles of the two types of diversification, they argue that incentive contracts with higher levels of managerial ownership will be inefficient, i.e., counter to shareholder interests—reducing international diversification and increasing business diversification. Our findings support our arguments for international diversification. They find no significant effect for business diversification after accounting for endogeneity and serial correlation.

Midiastuty and Mahfoedz (2003) find out that the managerial ownership has negative influence on the earnings management. Faisal (2004) states that the size of the amount of managerial share ownership in a company can indicate the congruence of interests between the management and the shareholders. The research result by Ujiyantho and Bambang (2007) state that there is a negative influence between managerial ownership and earnings management.

Thus, the hypothesis in this research is:

H_4: Managerial ownership influences to the earnings management

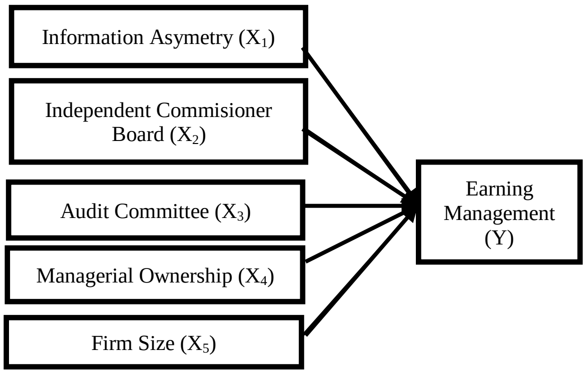
Sirat (2012) analyzed the effect of corporate governance practices, ownership, and firm size on the amount of earnings management. It was conducted in the companies listed in Indonesia Stock Exchange. Ownership structure can be divided into institutional ownership and family ownership; firm size was measured by market capitalization. The corporate governance practices were measured using three variables (audit quality, the proportion of independent board, and the existence of audit committee). It was found out that firm size and family ownership have a significant influence on the amount of earnings management. The larger the company is, the smaller management is on average earnings and earnings management in the firms with high family ownership. Those that are not corporate conglomerate are higher than average earnings in the management of other companies. The practice of corporate governance and institutional ownership variable did not have significant effect on the amount of earnings made by company management.

Lusi (2013) showed that two of the corporate governance variabels, namely board of director and audit quality, as well as firm size are statistically significant in explaining earnings management measured by discretinoary accruals.

From some research above, then the hypothesis for this research is:

H_5: Firm size influences to the earnings management

Figure 1. Research Framework



Based from study preview, this research has a new study that has never been done before.

The population in this research is all manufacture companies listed in Indonesia Stock Exchange. The sampling was conducted using purposive sampling method. Information asymmetry measured withrelative bid-ask spread; independent commissioner board measured withthe percentage of independent commissioner members from the total commissioner board in the company; audit committee measured withdummy variable; managerial ownership measured withthe percentage in the share capital owned by the management from the total capital of the company; firm size measured withnatural logarithm of the total assets, and earnings management measured withThe Modified Jones Model to calculate the discretionary accrual.

This research was conducted by using multiple linear regression analysis. After testing normality, multicoloniarity, autocorrelation and heteroscedasticity the research model is expressed BLUE (Best Linear Unbiased Estimator).

4. ANALYSIS RESULT

The number of the samples of the company that fulfill the criteria of purposive sampling in this research is 55 companies or 165 observation data.

The result of multiple linear regression test can be seen in the following table.

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.049	.147		-.337	.737
	X1	.004	.001	.215	2.626	.009
	X2	-.001	.001	-.063	-.812	.418
	X3	.004	.019	.016	.206	.837
	X4	-.005	.002	-.233	-2.900	.004
	X5	.001	.006	.012	.138	.890

Based on the result of the regression estimation it is obtained that the multiple linear regression equation in this research is as follows:

$Y = -0{,}049 + 0{,}004X_1 - 0{,}001X_2 + 0{,}004X_3 - 0{,}005X_4 + 0{,}001X_5$

The result of the statistical test shows that partially, information asymmetry (X_1) and managerial ownership (X_4) has significant influence on the earnings management but Commissioner Board (X_2), Audit Committee (X_3) and Firm size (X_5) are proved of having no influence on the earnings management.

5. DISCUSSION

The result of this research proves that information asymmetry has positive and significant relationship to the earnings management (hypothesis 1, accepted). It means that if the information asymmetry level is high, then the earnings management practices will occur more, and vice versa. With the existence of information asymmetry, the earnings management will occur easier. This surely gives bad impacts for the shareholders; shareholders wrong in decision-making.

The research result proves that the proportion of independents commissioner board had no influence on the company's earnings management (hypothesis 2, rejected). According to Veronica and Siddharta (2005), the existence of independen commissioner board is less effective in reducing the earnings management the minimum requirement of the independent commissioner board in Indonesia is 30% that might not be high enough to make the independent commissioners dominate the policy made by the commissioner board.

Research result shows that audit committee has no influence on the earnings management (hypothesis 3, rejected). This might be caused by the establishment of audit committee that is conducted merely to fulfill the regulation. Besides, the existence of audit committee will be bias since one of the members of independent commissioners serves as the audit committee leader as well, then there will be overlap in running the tasks in supervising the management performance.

The research result shows that the managerial ownership has significant influence on the earnings management with negative coefficient direction (hypothesis 4, accepted). It means that the greater managerial ownership owned by the company, the smaller the earnings management done in that company. With the shares owned by the managers, they will act accordingly based on the interests of the shareholders to minimize the behavior of the manager opportunist. In smaller share ownership, the incentive for the possibility of the occurrence of managers' opportunistic behavior will increase (Scheileifer and Vishny, 1997). This research result is consistent with the research result by Ujiyantho and Bambang (2007) that state that the managerial ownership has negative influence on the earnings management but contradicts to the research result by Rahmawati (2013). Therefore, it can concluded that managerial ownership is one of the ways that can be used to reduce company's earnings management.

This research result shows that firm size has no influence on the earnings management (hypothesis 5, rejected). This supports the research by Nasution and Setiawan (2007), but contradicts to the research by Desmiyawati, et al. (2009). Therefore, it can be concluded that the earnings management occurs due to individual's behavior, which is opportunistic behavior from the managers who want to take benefit for themselves.

6. CONCLUSION

The result of this research shows that partially, only information asymmetry and managerial ownership that have significant influence on the earnings management. Simultaneously, it is proved that information asymmetry, independent commissioner board, audit committee, managerial ownership, and firm size have significant influence on the earnings management of the manufacture companies listed in Indonesia Stock Exchange in 2010-2012 period.

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