

The Influence of Information Asymmetry, Independent Commissioner Board, Audit Committee, Managerial Ownership and Firm Size on Earnings Management

by Cek Turnitin

Submission date: 29-Apr-2023 07:11PM (UTC+0700)

Submission ID: 2079131429

File name: Earnings_Management_Medwell.docx (49.97K)

Word count: 2858

Character count: 17091

The Influence of Information Asymmetry, Independent Commissioner Board, Audit Committee, Managerial Ownership and Firm Size on Earnings Management

Lita Yulita Fitriyani, Sutoyo, Sri Suryaningsum and Vivin Marlita Rohmawati
Faculty of Business and Economics
University of National Development "Veteran" Yogyakarta, Yogyakarta, Indonesia

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 is measured using relative bid-ask spread, independent commissioner board is measured using the percentage of independent commissioner members from the total commissioner board in the company, audit committee is measured using dummy variable, managerial ownership is measured using the percentage in the share capital owned by the management from the total capital of the company, firm size is measured using natural logarithm of the total assets and earnings management is measured using. The modified Jones model to calculate the discretionary accrual. This research employs the sample from the manufacture companies listed in Indonesia stock exchange in 2013-2015 observation period of 55 companies. The sampling conducted is purposive sampling technique, Analysis method used is multiple linear regression. Based on the hypothesis testing using multiple linear analysis method in this research, 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 listed in Indonesia Stock Exchange.

Key words: Information asymmetry, independent commissioner board, audit committee, managerial ownership, firm size, earnings management

INTRODUCTION

Setiawati and Naim (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. 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.

Literature review: According to Scott 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 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, 2007).

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 affect its ability to act independently or to act for the sake of the company.

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 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.

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 (incentive alignment 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 divides the ways to understand earnings management. First to see the behavior of the manager's 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 manager's expectations both for individual interest and company interest.

MATERIALS AND METHODS

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 al, (2013) investigates how information asymmetry and mutual fund ownership affect listed earnings management. They show that reducing information asymmetry improves firm's earnings management behavior and the information environment significantly increases the effect of long-term mutual funds on firm's earnings management. From some

research above then the hypothesis for this research is:

- H₁: 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 government is realized Xie et al (2003) researched on the role of commissioner board with the financial aspect background in preventing the earnings management. The research conducted by Ujjiyanto and Bambang as well as Nasution and Setiawan 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:

- H₂: 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 al. (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

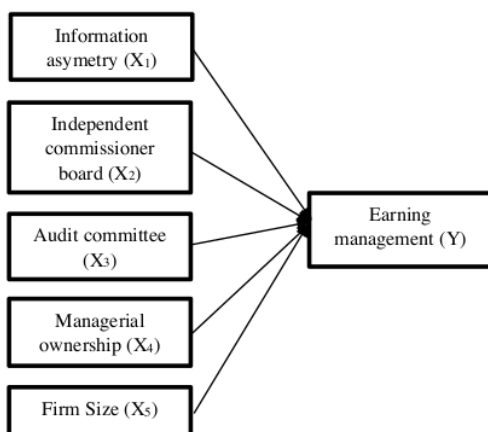
been the focus of considerable debate. Xie et al. (2003) conclude that the active independent commissioner and audit committee that have research is knowledge about finance might be a crucial factor in preventing the manager's tendency to do earnings management. From some research above then the hypothesis for this research is:

- H₃: 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 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 Ujjiyantho and Bambang state that there is a negative influence between managerial ownership and earnings management.

Figure 1. Research framework



So, the hypothesis is:

- H4: 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 compares 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 showed that two of the corporate governance variables, namely board of director and audit quality as well as firm size are statistically significant in explaining earnings management measured by discretionary accruals. From some research above then the hypothesis for this research is:

- H5: firm size influences to the earnings management

Based from study preview, this research has a new study that has never been done (Fig. 1). The population in this research is all manufacture companies listed in Indonesia Stock Exchange. The sampling was conducted using purposive sampling method. Information asymmetry is measured using relative bid-ask spread, independent commissioner board is measured using the percentage of X independent commissioner members from the total commissioner board in the company, audit committee is measured using dummy variable, managerial ownership is measured using the percentage in the share capital owned by the management from the total capital of the company. firm size is measured using natural logarithm of the total assets and earnings management is measured using the modified Jones model to calculate the discretionary accrual.

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

RESULTS AND DISCUSSION

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 Table 1. 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) and managerial ownership (X) has significant influence on the earnings management but commissioner board (X) audit committee (X) and firm size (X) are proved of having no influence on the earnings management.

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 the

existence of independent 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.

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 is 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 of the occurrence of manager's opportunistic behavior smaller share ownership, the incentive for the possibility will increase (Scheileifer, 1997). This research result is consistent with the research result by Ujiyantho and Bambang that state that the managerial ownership has negative influence on the earnings management but contradicts to the research result by Rahmawati (2007) 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 but contradicts to the research by Desmiyawati 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.

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. Audit committee, board of director influence on the earnings management of the manufacture companies listed in Indonesia Stock Exchange in 2010-2012 period.

Table 1: The results of multiple linear regression text coefficients

Models	Unstandardized Coefficients (B)	SE	Standardized Coefficients (β)	t- values	Sig.
Constant	-0.0490	0.147	-	-0.337	0.737
X ₁	0.004	0.001	0.215	2.626	0.009
X ₂	-0.0010	0.001	-0.063	-0.812	0.418
X ₃	0.004	0.019	0.016	0.206	0.837
X ₄	-0.0050	0.002	-0.233	-2.900	0.004
X ₅	0.0010	0.006	0.012	0.138	0.890

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 biased, since one of the members of independent commissioners serves as the audit committee leader as well

REFERENCES

- Alessandri, TM. and A Seth, 2014 The effects of managerial ownership on international and business diversification Balancing incentives and risks Strategic Manage. J., 35: 2064-2075.
- Badolato, P.G., D.C. Donelson and E. Matthew, 2014. Audit committee financial expertise and earnings management: The role of status. J. Accounting Econ.. 58: 208-230.
- Dai, Y. D. Kong and I. Wang, 2013. Information asymmetry, mutual funds and earnings management: Evidence from China China J. Accounting Res, 6: 187-209.
- Faisal, SE, 2004. Cost analysis agency, ownership structure and mechanism of good corporate governance Micro-Star International, Zhonghe District, Taiwan.
- Hartono, I, 2008. Portfolio Theory and Investment Analysis Gadjah Mada University, Yogyakarta, Indonesia,.
- Klein, A., 2002. Audit committee, board of director characteristics and earnings management. J.Account. Econ, 33: 375-400.
- Rahmawati, 2007. Detection model management profit on public banking industry in Indonesia and its effect on performance of banking. J. AccountingManage, 18: 23-24.
- Scheileifer, D.V., 1997. Corporate governance principles of corporate governance in Greece. Intl. Rev 9.89-100.
- Setiawati, L. and D. Naim, 2000, Earnings management. J. Econ. Bus. Indonesia, 15: 424-441.
- Sirat, H, 2012 Corporate governance practices, share ownership structure and size on earning management. J. Econ Bus. Accountacy Venura, 15:145-156.
- Xie, B, W.N. Davidson III and P.J. DaDalt, 2003. Earnings management and corporate governance: The role of the board and the audit committee. J. Corporate Fin 9:295-316.



The Influence of Information Asymmetry, Independent Commissioner Board, Audit Committee, Managerial Ownership and Firm Size on Earnings Management

ORIGINALITY REPORT

10%

SIMILARITY INDEX

13%

INTERNET SOURCES

8%

PUBLICATIONS

0%

STUDENT PAPERS

PRIMARY SOURCES

1

www.scribd.com

Internet Source

6%

2

onlinelibrary.wiley.com

Internet Source

5%

Exclude quotes On

Exclude matches < 3%

Exclude bibliography On