



Analysis of Governance, Leverage and Financial Distress Conditions on Earnings Management in the Banking Services Sector in Indonesia

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ABSTRACT

This research is motivated by the existence of information asymmetry and the tendency of investors to pay more attention to earnings information as a parameter of company performance, which will encourage management to manipulate earnings which is called earnings management. The purpose of this study was to identify the effect of governance, leverage and financial distress conditions on earnings management in companies listed on the Indonesia Stock Exchange (IDX) focused on the banking sector. The method used is a quantitative descriptive method, with 35 data samples from 5 companies that have met the research sample criteria in the banking services sector for the period 2013-2019. The results of this study were analyzed and processed by statistical tests showing that leverage has a positive and significant effect on earnings management,

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INTRODUCTION

One of the important parameters in financial statements measuring management performance is profit. The tendency to pay more attention to the value of earnings which is the benchmark for managers' performance, leads to deviant management behavior, one of which is the practice of earnings management. Earnings management practices by managers that originate from conflicts of interest and the existence of information asymmetry can be minimized through a monitoring mechanism that aims to align these various interests (Midiastuty and Machfoedz, 2003; in Febriyanti, Putri, & Suyono, 2016).

The misalignment of interests between the principal and the agent can be done through good corporate governance. Corporate governance is a series of processes, customs, policies, rules and institutions that influence the direction, management, and control of the company. The corporate governance mechanism can be proxied by the composition of the board of directors, managerial ownership and independence of the audit committee (Krisnauli, 2014). Financial distress is another factor that triggers management to carry out earnings management. Financial difficulties can be interpreted as the company's inability to pay its financial obligations when due which causes the company's bankruptcy (Darsono and Ashari, 2005; Iskamto, 2015; Iskamto & Ghazali, 2021; Sukmadewi, 2021)).

The ability and risk of the company that is needed by investors, namely the leverage ratio which is an alternative source of company funds besides selling shares is debt. Debt comes from external funds, where the company tries to fulfill the debt agreement in order to obtain a good assessment from creditors. This can then motivate managers to carry out earnings management to avoid debt covenant violations. Research conducted by (Dechow et al., 1996; in Jao, 2011). The above problems regarding earnings management can be seen in companies listed on the IDX as follows:

Table 1. Comparison of Company Earnings Management Reports

No	Nama Perusahaan	Tahun	Data yang Sebenarnya	Data yang Dilaporkan	Selisih
1	Bank Bukopin	2016	183,53 Miliar	1,08 Triliun	▲ 816,47 miliar
2	PT. Agis Tbk	2007	466,8 Miliar	800 Miliar	▲ 333.2 Miliar
3	PT. Inovisi Infracom	2015	59 Miliar	1,9 Triliun	▲ 1,841 Triliun

Source: www.idx.co.id

Table 1 of the data above explains that in 2016 Bank Bukopin revised its financial statements which caused a number of variables in the report to change significantly such as profit, total interest income and sharia. There is a profit difference of Rp816.47 billion in 2017 (<https://economy.kompas.com>, posted on 3 May 2018, 07:00 WIB, accessed on 21 July 2020). In 2007 PT. Agis based on the results of Bapepam's examination was proven to have provided materially incorrect information related to the revenues of the 2 (two) acquired companies, namely PT. Akira Indonesia and PT. TT Indonesia, there was an increase in the difference of Rp. 333.2 billion from the data that should have been reported (<https://business.tempo.com>, posted on: December 17, 2007, accessed on: July 21, 2020).

In 2015 PT. Inovisi Infracom, based on the IDX examination, there are indications of misstatements in INVS's financial statements for the period September 2014. In the INVS information disclosure dated February 25, 2015, in the first semester of 2014 salary payments to employees were Rp. 1.9 trillion. However, in the third quarter of 2014 the number of salary payments to employees fell to Rp. 59 billion. There is an increasing difference of 1.841 trillion in reporting in the financial statements (<https://finance.detik.com>, posted on: 18 May 2015, accessed on: 21 July 2020). The explanation makes it interesting to discuss this study further in a scientific paper that focuses on discussing governance, leverage and the condition of the company's financial difficulties on earnings management in companies listed on the Indonesia Stock Exchange in the banking sector for the period 2013 - 2019.

RESEARCH METHODOLOGY

This research method uses quantitative methods that are processed statistically. The variable operational indicators used in this study. The research population in the banking sector listed on the Indonesia Stock Exchange is 36 issuers. Purposive sampling was used in determining the research sample according to the criteria that had met the requirements, so that the number of samples in the study was 5 issuers according to the 2013-2019 period of 7 years. There are 35 financial statement data observed. The method used for data analysis in this study is hypothesis testing using t-test and F-test.

Table 2. Operational Variables

Variables	Indicator
Governance (X1)	Board Size = Ln(Total Board of Directors Managerial Ownership = Total shares owned by the manager/Total shares outstanding Independence of the Audit Committee = Proportion of independent members on the audit committee
Leverage (X2)	Leverage = Total Debt/Total Equity
Financial difficulties (X3)	financial difficulties = (1) If the entity faces negative income (0) If the entity does not face positive income)
Earnings Management (Y)	TACC-NDA

DISCUSSION

FINDING AND DISCUSSION

The t-test is a test of the regression coefficients for each variable of governance, leverage, and financial distress by comparing the p-value in the Sig column of each independent variable with a significant level of 0.05 used.

Table 3. Partial Test Results (t Test)

Model	Unstandardized Coefficients		Standardized	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.011	.057		-196	.846
1 Governance	.003	.043	.010	.065	.948
Leverage	.015	.005	.490	3.187	.003
Financial Distress	.045	.025	.271	1,771	.086

Source: self-processed, 2020

Based on ttable (35-4-1) explains the value of 1,697. The results of the t test explain that 1) the results of testing the governance variable have a positive value of 0.065 with a significant value of 0.948 (Ho is accepted and Ha is rejected), meaning that the governance research hypothesis has a positive and insignificant effect on earnings management. 2) the results of testing the leverage variable have a positive value of 3.187 with a significant value of 0.003 (Ho is rejected and Ha is accepted), the research hypothesis of leverage has a positive and significant effect on earnings management and the results of testing the financial distress variable have a positive value of 1.771 with a significant value of 0.086 (Ho is accepted and Ha is rejected), meaning that the research hypothesis of financial difficulties has a positive and insignificant effect on earnings management.

Statistical test "F" or simultaneous significance test to see all the variables of governance, leverage, and financial difficulties have a joint effect on earnings management variables.

Table 4. Simultaneous Test Results (F Test)

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	.048	3	.016	4.060	.015 ^b
1 Residual	.121	31	.004		
Total	.168	34			

Source: self-processed, 2020

The research data used were 35 using 3 independent variables and 1 dependent variable. So that the Ftable (4-1) (35-3-1) found is 2.91, so that the simultaneous test (F test) shows that the significance F value is 0.015 which means it is smaller than 0.05 and the Fcount > Ftable (4.060 > 2.91), which means that the variables of governance, leverage, and financial difficulties studied simultaneously have a significant effect on earnings management in banking sector service companies listed on the IDX for the period 2013 – 2019. Furthermore, the coefficient of determination (Adjusted R Square) is 0.213 which is equal to 21.3. % can be seen in the following table:

Table 5. Coefficient of Determination Test Results (R2)

Model	R	R Square	Adjusted Square	Std. Error of the Estimate
1	.531 ^a	.282	.213	.0624639986

Source: self-processed, 2020

The value of the coefficient of determination explains that governance, leverage and financial difficulties together can explain earnings management by 21.3%, while the remaining 79.7% (100% - 21.3%) is influenced by other variables not included in this study.

Discussion

Based on the results of the t test, the results of data analysis showed that the governance variable showed positive and insignificant results on earnings management because it showed significant results of $0.948 > 0.05$. Governance is measured by the elements of board size, managerial ownership and the independence of the audit committee. This problem shows that the size of the board is not the main determinant of the effectiveness of supervision of the management of a company, but depends on the values, norms and beliefs accepted by the organization. This explanation further explains that the effectiveness of supervision depends on communication, coordination, and decision making (Natalia & Pudjolaksono, 2013). Furthermore (Boediono, 2005; in Praditia, 2010) also states that the application of managerial ownership mechanism does not contribute to controlling earnings management actions. This problem also causes the role of the audit committee from outside which is usually difficult to access financial reports, so it has not been able to carry out a more optimal monitoring role. This explanation causes governance to have no significant effect on earnings management in the banking case in Indonesia discussed in this study.

The results of data analysis, the leverage variable shows a positive and significant effect on earnings management where the results of data processing show significant results of $0.003 < 0.05$. This means that leverage reflects how much debt the company has in obtaining capital, where the greater the

leverage, the higher the earnings management practice, this causes the avoidance or violation of debt agreements. The debt-covenant hypothesis states that all other things being equal, the closer the firm is to accounting-based debt covenant violations, the more likely firm managers are to choose accounting procedures that transfer reported earnings from future periods to current periods (Jao, 2011). . Some companies may fail to pay their debts in the future, because reported net income has increased. So it is very possible that company managers influence the value of accounting accounts in financial statements, especially on the company's net income.

Based on the results of data analysis, the financial distress variable showed positive and insignificant results on earnings management where the results of the data processing showed significant results of $0.086 > 0.05$. If the value is small, it does not have an effect on the company, but if the value is large, it will have an impact on financial performance. It is necessary for the management to conduct periodic financial distress checks. This explanation has been conveyed by (Melinda & Widayarsi, 2019), who said that if the problem of financial difficulties remained stable or even reduced, then the company experienced a good change in the problem of financial difficulties. If the funding problem increases, the company will carry out earnings management to save the company. The explanation of the case in this study found that companies experiencing financial difficulties do not always carry out earnings management because not all financial constraints experienced by the company have too large a value and this is still company can handle.

Based on the results of the F test showed that together they showed positive and significant results where the significant results were $0.015 < 0.05$. Earnings management can occur because of less optimal corporate governance and the greater the leverage ratio, the greater the practice of earnings management in avoiding debt covenant violations. Furthermore, financial difficulties also have an influence on earnings management. This is also supported by research (Aprilian and Hapsari, 2020) which explains that simultaneously or jointly managerial ownership, independent commissioners, audit committees and leverage have a significant influence on earnings management in the sector. basic and chemical industry.

CONCLUSION

Based on the analysis of the research results that have been carried out, it can be concluded that 1) The existence of the independence of the audit committee and the board of directors in governance in banking companies in Indonesia still meets the provisions of the regulator (government). Managerial ownership has no effect on earnings management, this is because the percentage of managers who own shares is relatively very small when compared to the total capital owned by general investors. 2) Leverage shows a positive and significant effect on earnings management, this is the impact of the amount of debt or the obligation to pay installments and interest at maturity. 3) Companies experiencing financial difficulties do not always carry out earnings management, because if the financial constraints experienced by the company are not too large, then earnings management can still be avoided and the problems that occur can be overcome by the company as well as possible.

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