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DETERMINANTS OF GOOD CORPORATE GOVERNANCE, FIRM SIZE, PROFITABILITY, AND LEVERAGE ON EARNING QUALITY

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ABSTRACT

Earnings management as a financial statement manipulation is not a new issue in the existing business. Yet, conducting income smoothing is suspected of keeping going in preparing the financial reports in specifying the profit with trickery. This paper wants to examine the determinants of some variables on earnings quality by employing the empirical data obtained from go public manufacturing companies' periods of 2018 to 2020 in Indonesia. This study uses multiple linear regression to analyze, which is processed in accordance with the research purpose. The results achieved are some of the independent variables, namely Good corporate Governance, Company Size, and Leverage do not affect earnings quality, while Profitability does not significantly affect earning quality. The findings have important implications for company managers, better performance, and policymakers and provide useful information to assist the potential to invest, not only focusing on the profit reported without considering the other factors disclosed in the financial statements.

***Keywords**: Earnings Quality, Good Corporate Governance, Firm Size, Profitability, Leverage.*

INTRODUCTION

The foremost essential of earnings information is the usefulness of manager roles in preparing financial statements for internal and external parties. It often triggers the emergence of asymmetry information between management and principals, which is called agency conflict (Wati & Putra. 2017). Basically, as a principal, the owner or investor certainly wants a favorable return on their investment. The appointed CEO's company is expected to avoid all business activities undertaking the earnings management according to their volition to prejudice investors or principals. Financial statements manipulation, called earnings management, is not a new issue in the existing business. It is a condition where management intervented in preparing the financial reports for external sides, which could increase and decrease the profits (Schipper, 1989 in Gunawan et al., 2015). That occurs when managers assess financial reports and transaction structure by modifying the financial statements that confuse mislead of information achievements and certain income (Healy & Wahlen, 1999). Earnings quality reflects the actual financial performance of the company (Boediono, 2005).

The earnings quality of the general financial reports is important for those who use financial statements for contractual purposes and investment decision-making (Wati & Putra, 2017). Meanwhile, Leisa et al. (2017) say that quality accounting earnings can be perceived as cracked earnings and reflect the company's financial performance. Income smoothing or earnings quality is an attempt to increase the amount of reported profit if the actual profit is smaller than the normal profit and an attempt to reduce the amount of reported profit if the normal profit is smaller than the actual profit. In simple terms, it is an action that is intentionally carried out by managers using special tools in earnings quality.

Theories of corporate governance are rooted in agency theory with the theory of moral hazard implications, developing further within stewardship theory and stakeholder theory and evolving at resource dependence theory (Valentive, 2009).

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Since a few years ago, many researchers and academia have tried determining earnings quality determinants. Many factors can be affected by that, such as social and environmental issues, the company's performance, and market behavior. Research conducted by Muid (2009) found that the mechanism of Good Corporate Governance, namely managerial ownership and institutional ownership, positively influences earnings quality, while the board of commissioners and audit committees has no effect on earnings quality. Furthermore, a study by Pitria (2017) reveals that managerial ownership has no effect on earnings quality, whilst the audit committee and independent commissioners have an influence on earnings quality. In other research, Good Corporate Governance also has an influence on the effort to achieve optimal business performance (Aldrige, et al. 2005). Good quality earnings which can increase the business prosperity and company accountability, are desired by the shareholder in the long term. Likewise, the value of company size, capital structure, earning persistence, earning growth, liquidity, and accrual liquidity significantly affect earnings quality (Wati & Putra (2017). In fact, measuring the value added measurement is beneficial as it encompasses the complicated framework of a firm. It is also understood that the firm's size in contracts and monitoring is larger for larger and more complicated businesses (Kaen & Baumann, 2003). Smaller firms may not acquire the required resources for the congregation and present a wide array of information (Buzby, 1975). However, this argument may not hold correctly in all cases, particularly because of rapid growth. Investors will trust the more prominent companies, and they would be implemented better management, which tends to make the investors more confident.

In addition, profitability is an essential factor for surviving a company because without profits, it will be difficult to pay any costs (Pitria, 2017). The board of management and owners are trying to increase the profits for survival and advancement. To conduct profitability can use Return on Equity and Return on Total Assets (Horne). Then, the earnings quality has relevance to leverage, as a company's ability to comply with all obligations on time (Fahmi, 2013). The funds can be obtained either from internal or external sources related to the profits obtained. If the leverage structure is high, it tends to carry out significant earnings management. The profit quality will more generally decrease.

Based on the previously described, earnings quality or earnings management can be influenced by several existing factors. This study addresses examining determinants of earnings quality. The sample comprises 37 manufacturing companies listed on Indonesia Stock Exchange in 2017 - 2019. This brief period of income smoothing in management fraught with growth makes manufacturing companies unique among developed countries like Indonesia. An analysis of the environmental performance–financial performance relationship in an Indonesian context may provide insights for policymakers, managers, and investors since Indonesia has planning to take advantage of an earnings profit policy. The objectives of conducting this research is to know if any/or not significant effects of some factors like Good Corporate Governance, Company Size, Profitability, and Leverage to Earnings Quality are primary issues. Some endogenous variables.

The remainder of this article is organized as follows. The next section develops the hypothesis, followed by the research design, including information about the sample, research method, and descriptive statistics. Then, reports the empirical results and analysis. The last section concludes with recommendations and an explanation of the study's limitations.

The information about profit measures the success or failure of a business to achieve the set of operating goals. In Belkaoui (2012), profit as a predictive way to forecast the economic events in the future to present quality earnings is essential as the basis for relevant information for users, especially when making decisions. The quality of earnings reflects the actual financial performance (Boediono, 2005). Likewise, Leisa et al. (2017) says that quality accounting earnings can be defined as earnings that have a little perceived rumble, and can reflect the real financial performance

According to Dechow et al. (2009), three things must be emphasized in the quality of earnings. First, it depends on the information. Second, figures whether the information describes the financial performance, and third is to determine the relevance of the financial performance that underlies the decisions and ability of the accounting system to measure the company's performance. Furthermore, Darsono & Ashari (2010) state that one characteristic of determining earnings quality is the relationship between profits earned and cash from operating activities.

According to Monks et al. (2006), good corporate governance is a system that regulates and controls the companies and creates added value for all parties. The management could use the resources efficiently, effectively, economically, and productively by applying the five existing principles of transparency, accountability, responsibility, independence, equality, and fairness (Gahani & Putra, 2017). KNKG (2004) states the independent commissioner is a part of the board of commissioners and has the responsibility to carry out specific or general monitoring and provide advice. Furthermore, it can affect the integrity of some financial reports produced by management and protects the rights of some parties (Wawo, 2010). The main function of an audit committee is to provide recommendations related to the issues of financial, accounting and control policies (KNKG. 2006). In Prastiti (2013), the existence of an effective audit committee is able to improve the quality and credibility of auditing and assist the CEO in advancing the interests of shareholders. The company size is related to earnings quality because the larger firm will improve its financial performance, and there is no need to practice earnings manipulation (Gahani & Putra, 2017).

Regarding increase profits, there are two ways to obtain the sources of funds, capital market and banking financing (Setiawan, 2009). Profitability ratios measure the effectiveness of management as a whole. Some ratios like Return on Assets indicate it as the value of profits obtained compared to total investment. The higher the profitability ratio, the better ability of the company to earn high profits (Fahmi, 2012).

Similarly, Harahap (2002) states that the more significant ratio, the better the financial performance. The leverage or capital structure is a variable to determine how much the company's assets are financed by debt or equity (Irawati, 2012). In this case, a high leverage ratio means the profit can also increase. The company must be appropriately managed.

Some previous research has been conducted, like the study of Wati & Putra (2017), which reveals that GCG has a positive effect on earnings quality, while firm size and leverage do not affect earnings quality. Putri et al. (2017), the committee size and audit quality significantly affect earnings quality, and independent commissioners have a negative but not significant effect on earnings quality. The study by Tutut Muniarti et al. (2018) mentions that independent commissioners and institutional ownership have no significant effect on earnings quality. Furthermore, GCG, firm size, leverage, and profitability positively affect earnings quality (Mashela & Maryono. 2017). According to Nur Salma & Januar Riska (2019), the leverage and profitability ratios significantly affect earnings quality. The other study by Putri Citra et al. (2017) says the audit committee, firm size, and independent commissioners significantly affect earnings quality. However, Nugroho et al. (2019) reveal that firm size has no significant effect on earnings quality, but leverage has a significant effect on earnings quality. The study by Ananda et al. (2016) mentioned that firm size has a positive and significant effect on earnings. Research by Hardiah et al. (2017), conducted by the board of commissioners, does not affect the earnings quality, but the company's size has a positive influence on earnings quality.

RESEARCH METHOD

This type of research is quantitative, which is conducted using numbers and statistical examinations. Some manufacturing companies used as a subject in this study were listed on the Indonesia Stock Exchange during the 2017 – 2019 years. Using the purposive sampling method to be obtained 37 corporates as a sample. Secondary data uses as panel data achieved from the audited annual reports published consistently for the research periods. Those data were examined by using multiplier regression analysis. These results will be composed sequentially with descriptive statistics, classic assumptions, multiplier regression, coefficient of determinant, and hypothesis tests.

This study uses five independent variables like Independent Commissioners, Audit Committee, Firm Size, Profitability, and Structure of Leverage on Earnings Quality. In addition, Independent Commissioners and Audit Committee to robust Good Corporate Governance. Chow test, Hausman test, and Lagrange test were carried out to estimate the regression model using Common Effect Model, Ordinary Least Square, and Random Effects Model approach.
In addition, the research regression model is formulated:

EQ = b0 + b1Independent Commisioners+ b2Audit Committee+ b3Firm Size + b4Profitability + b5Leverage + Ɛ

Based on the above explanation and previous research, this study is proposed five hypotheses as follow:
H1: Independent Commissioner has an effect on Earnings Quality
H2: Audit Committee has an effect on Earnings Quality
H3: Firm Size has an effect on Earnings Quality
H4: Profitability has on Earnings Quality
H5: Leverage on Earnings Quality

ANALYSIS

This session, the finding results of statistical examines will be prepared sequentially.

Statistic Descriptive

Table 1. Descriptive Statistic Analysis

	EQ	IC	AC	SIZE	ROA	DAR
Mean	0.876383	0.393404	3.036036	23.10895	0.086901	0.375850
Median	0.931683	0.375000	3.000000	25.66354	0.074963	0.357762
Maximum	1.926290	0.666667	5.000000	30.52948	0.446758	1.571057
Minimum	-0.442194	0.200000	1.000000	12.47555	-0.220089	0.133061
Std. Dev.	0.518076	0.100174	0.445746	5.551259	0.095595	0.206655
Skewness	-0.431972	0.287165	0.786953	-0.284377	0.593786	2.106682
Kurtosis	2.668689	2.906164	13.18243	1.556288	6.128208	11.87429
Jarque-Bera	3.959768	1.566300	490.9861	11.13600	51.78154	446.3374
Probability	0.138085	0.456964	0.000000	0.003818	0.000000	0.000000
Sum	97.27852	43.66786	337.0000	2565.094	9.645979	41.71933
Sum Sq. Dev.	29.52428	1.103837	21.85586	3389.812	1.005225	4.697713
Observations	111	111	111	111	111	111

Source: Data research conducted, Eviews 10

Table 1 figures the EQ has a minimum value of -0.442, which is obtained by Asia Pacific Investama in 2019, while Alkindo Naratama owned a maximum value of 1.926 in 2018. Most companies are more than the average or mean value of 0.878. Furthermore, IC has a minimum value of 0.200, which Kimia Farma, Asia Pacific Investama, Unilever Indonesia, and Semen Baturaja achieve. Meanwhile, the maximum value of 0.667 by Jembo Cable Company. The mean value is 0.393 indicates the existing prevalent distribution. The variable AC has a minimum value of 1.000, owned by Japfa Comfeed Indonesia in 2017, and a maximum value of 5.000 by Charoen Pokphand Indonesia in 2017 and 2018. The mean value is 3.036 and indicates more companies have KA. The Size has a minimum value of 12.475 by Astra in 2016 with a maximum value of 30,529 owned by Kalbe Farma in 2018. The average value obtained is 23.108, and more companies have a size value less than the average value. For ROA variable has a minimum value of -0.220 by Asia Pacific Investama in 2017 with a maximum value of 0.446 owned by Unilever Indonesia in 2019. The mean value obtained is 0.086, and it concluded that most companies have ROA more than the average value. Lastly, the DAR has a minimum value of 0.133, which is owned by Indocement Tunggal Prakarsa in 2017, with a maximum value of 0.157, owned by Asia Pacific Investama in 2016. The average value obtained is 0.375, revealing that most companies have DAR less than the average value.

Classic Assumption Tests

The classic assumption tests were carried out. The findings are all data used normally. There is nothing multicollinearity, autocorrelation, and heteroscedasticity problems. Therefore, it can be continued to conduct the other examinations by using the Fixed Effect Model.

Multiplier Regression Analysis

Table 2. Coefficient Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.476245	0.471271	1.010555	0.3146
IC	0.607351	0.480023	1.265254	0.2086
AC	0.108208	0.104718	1.033326	0.3038
SIZE	-0.011566	0.008851	-1.306801	0.1941
ROA	1.616541	0.529686	3.051888	0.0029
DAR	-0.107793	0.247288	-0.435900	0.6638

Source: Data research conducted, Eviews 10

Based on table 2 can prepare the equation of coefficient regression, as follows:

EQ = 0.476245 + 0.607351 IC + 0.108208 AC – 0.011566 SIZE + 1.616541 ROA – 0.107793 DAR

The constant value is 0.47. If all independent variables are zero, the outcome of the EQ has remained at 0.476. The coefficient of regression IC is 0.607, which reveals that for every accretion of IC by 1, the Earning Quality will increase by 0.607. A similar way can be conducted for the other variables.

Coefficient of Determinantion Test (R^2)

Table 3. The result of Coefficient of Determination.

R-squared	0.361216	Mean dependent var	0.876383
Adjusted R-squared	0.121274	S.D. dependent var	0.518076
S.E. of regression	0.485646	Akaike info criterion	1.445866
Sum squared resid	24.76449	Schwarz criterion	1.592327
Log likelihood	-74.24556	Hannan-Quinn criter.	1.505281
F-statistic	4.036242	Durbin-Watson stat	1.908239
Prob(F-statistic)	0.002169		

Source: Data research conducted, Eviews 10

Table 3 shows the coefficient of determination with an adjusted R-square of 0.361. This value indicates that the ability of the five variables in this study consisting of Independent Commissioners (IC), Audit Committee (AC), Firm Size (FS), Return on Assets (ROA), Debt to Assets Ratio (DAR) can define the Earnings Quality of 36.12%. In contrast, the rest 63.88% can be explained by other factors not examined in this research.

Hypothesis Tests (T-tests).

The significance effect is examined to determine whether the independent variables individually affect the dependent variable (Ghozali, 2018).

Table 4. Results of t-tests

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.476245	0.471271	1.010555	0.3146
KI	0.607351	0.480023	1.265254	0.2086
KA	0.108208	0.104718	1.033326	0.3038
SIZE	-0.011566	0.008851	-1.306801	0.1941
ROA	1.616541	0.529686	3.051888	0.0029
DAR	-0.107793	0.247288	-0.435900	0.6638

Source: Data research conducted, Eviews 10

Table 4 reveals that the independent commissioner variable has a probability value of 0.208, more than 0.05. Hence there is no significant effect on earnings quality. Likewise, to result of Audit Committee has a probability of 0.303 more than 0.05. It has no significant effect on earning quality for a firm size variable getting a probability value of 0.194 more than 0.05. The firm size does not affect earnings quality.

Meanwhile, the return on assets has a probability value of 0.002, less than the significance of 0.05. Hence it has a significant effect on earnings quality. The ultimate variable, debt to assets ratio, achieves a probability value of 0.663, more than 0.05, so this variable has a partially significant effect on earnings quality.

The Influence of Independent Commissioners on Earnings Quality

The Independent Commissioner variable does not affect earnings quality. This result is inconsistent with Darabali & Saitri (2017) research, which states that the independent commissioner positively influences earnings quality. However, it is like research conducted by Muniarti (2018), who stated the independent commissioner does not affect earnings quality. The existence of an independent commissioner may be fulfilling the required regulations. The presence of independent commissioners might not be essential to monitoring those operating activities and cannot ensure the company's performance is better. In addition, the designation of the commissioner board is determined through the voting of the majority shareholders. Although the composition of the independent board is relatively profound, it is no assurance that the commissioners will be carrying out their duties and making supervision properly. They bounded by the regulations and policies of the majority shareholder as well as cannot encourage them to implementable good corporate governance optimally to minimize or avoid earnings management. (Lestari & Cahyati, 2017).

The effect of the Audit Committee on Earnings Quality

Based on the above examination, the audit committee does not affect earnings quality. It is unlike the study by Lestari & Cahyati (2017), which states that the audit committee positively influences earnings quality. However, the result of this study is in line with research conducted by Puspitowati & Mulya (2014) state that the audit committee does not affect earnings quality. The more significant number of audit committee members, the more effective in supervising the financial reporting process because the existence of the audit committee is only to comply with what the regulations require.

The Effect of Firm Size on Earnings Quality

The firm Size variable does not affect earnings quality. It is supported by research by Wati and Putra (2017), which states that company size does not affect earnings quality because relatively large companies have an enormous potential profit and significant business risks. The advantages of relatively large companies are mostly deposited in the main posts, namely inventory or merchandise. It looks like a company has a high profit but does not guarantee the quality of profits. Generally, it is as inventories and receivables that have not been received in cash. The results of this study are inconsistent with research conducted by Ananda & Ningsih (2017).

The profitability ROA has a significant effect on earnings quality. It shows that the companies studied are being discovered as the proper companies to use their assets more effectively and efficiently. Therefore, the rate of return tends to be more qualified, minimizes, and avoids idle assets. In addition, companies with high returns can use them as internal funding resources (Brigham & Houston, 2001). The results follow the research by Savitri et al. (2014). However, it is not in accordance with the study by Marshela & Maryono (2017).

Effect of Leverage on Earnings Quality

The leverage variable does not affect earnings quality. These results is not in accordance with the research by Oktarya et al. (2014) that states the leverage of Debt to Assets Ratio does not affect earnings quality. Regardless, it is in line with the study of Wati and Putra (2017) and Patria (2017), who revealed that the leverage structure significantly affects earnings quality. If the company has a big percentage of debt to assets, it is not caused by interest expenses, but it manages its debt efficiently. The inventory or credit sales have been managed wisely, conservatively, or prudently. In addition, the high and low leverage cannot determine the earnings quality. Proper management obtains worthy leverage.

CONCLUSION

On the empirical results study, good corporate governance, firm size, and leverage do not affect earnings quality, while profitability affects earnings quality. Regarding these critical findings, all exogenous variables except profitability are revealed not to affect earning quality as new phenomena that still need to be studied further. There needs to be following some previous research that has been carried out. Nevertheless, profitability is expected to be considered a factor affecting earnings quality. This finding robustness the result by Savitri et al. (2014) that revealed that profitability has an essential role in earnings quality. The better performance of that quality is to minimize the negative effect of earnings management in maximizing income. In addition, this study may contribute and comply with the management in making decisions regarding the importance of maintaining and surveillance determinants on earnings quality. Likewise, these results can assist investors to be wiser in investing, not only focusing on the profit without considering others. However, this study has some limitations. For further researchers, it is recommended to expand the scope of research by adding independent variables and periods and using different measurements to achieve better results.

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