



THE EFFECT OF CORPORATE GOVERNANCE, LEVERAGE AND EXTERNAL AUDIT QUALITY ON PROFIT MANAGEMENT IN COMPANIES LISTED ON THE IDX IN 2018-2022

Nunuk Novianti¹, Indra Wijaya², Ani Febianingsih³

Universitas Bina Insani

nunuknovianti@binainsani.ac.id¹, indrawj-aak@binainsani.ac.id², ani.febianingsih@gmail.com³

Abstract:

Management, as well as those responsible for all company operational activities, can use their authority to influence financial reports. This research aims to analyze and determine the influence of Corporate Governance, Ownership Structure, Leverage and External Audit Quality on Profit Management in Companies Listed on the Indonesia Stock Exchange (IDX) in 2018 - 2022. The type of research used is quantitative descriptive. This research uses secondary data from financial reports with documentation techniques. The population in this research are companies listed on the Indonesia Stock Exchange (IDX) in 2018 - 2022. The sample was determined using the purpose sampling method, so there were 36 (thirty-six) companies studied that met the requirements. Hypothesis testing uses the SEM-PLS (Structural Equation Model – Partial Least Square) program. The research results show that Corporate Governance has a significant influence on Leverage and Profit Management, while others do not. However, leverage does not influence earnings management. Corporate governance significantly influences earnings management, and audit quality does not affect earnings management.

Keywords: corporate governance, ownership structure, leverage, external audit committee, earnings management

Corresponding: Nunuk Novianti

E-mail: nunuknovianti@binainsani.ac.id

INTRODUCTION

A company, in its operational activities, will produce a report as a performance measurement tool called a financial report, as a means of communicating information to internal and external parties of the company. The part or component of the financial report that is of primary concern is the profit and loss report and other comprehensive income that is the target of management. Management, as well as those responsible for all company operational activities, can use their authority to influence financial reports. One of the earnings management practices is to control the profits presented in financial reports. Earnings management has a direct impact on predictive financial report information on the company's future profits (Al Saedi, 2018).

Management's opportunities to manipulate profits can be minimized by implementing a control system through corporate governance. Corporate governance is proxied by institutional ownership and independent commissioners. The existence of institutional ownership and independent commissioners is considered an effective monitoring tool for the entity. Institutional ownership is considered to tend to be careful and thorough in the use of financial information to minimize managers carrying out earnings management practices. Kristianti & Setianingsih Research (2022) Institutional ownership influences earnings management. Different results from studies by Prihatiningtyas (2018) and Savitri & Priantinah (2019) show that institutional ownership does not affect earnings management.

The leverage factor is also considered to influence earnings management practices. Leverage is an assessment ratio for investors to see the capabilities and risks of an entity. The leverage variable is proxied by the debt-to-asset ratio. Sources of funds obtained through debt, shareholders can maintain their control over the entity by limiting the investments they make. Research that proves that leverage has a relationship with earnings management is proven by Wardani (2018) and Qomariyah (2018), contrary to the research results of Prihatiningtyas (2018), that leverage does not affect earnings management.

Independent auditors can also be used to enhance corporate oversight. An organization's ability to employ qualified auditors can serve as a powerful management monitoring tool and send encouraging signals to the market. A competent auditor's guarantee of accurate financial reporting can boost management responsibility and serve as a useful tool for shareholders to keep an eye on managerial duties (Indarti & Widiatmoko, 2021).

Auditor quality can be measured using Office of Public Accountant measures. The size of the Office of Public Accountant shows that the auditor's attitude is independent and professional, thereby minimizing management's ability to intervene in the auditor's views and opinions (Fionita & Fitra, 2021). Results of research conducted by Hadi and Tifani (2020) state that audit quality has a negative effect on earnings management. Albert and Widyastuti (2019) and Tarigan and Saragih (2020) state that audit quality has a positive effect on earnings management. Meanwhile, Wijayanti et al. (2021) state that audit quality does not affect earnings management.

This research aims to analyze and determine the influence of corporate governance, ownership structure, leverage and external audit quality on earnings management in companies listed on the IDX in 2018 - 2022. The independent variables in this research are corporate governance, ownership structure, leverage and external audit quality, while the dependent variable is earnings management.

METHOD

This study investigates secondary data from financial reports, annual reports, and sustainability reports for every firm listed on the Indonesia Stock Exchange from 2018 to 2022 using quantitative descriptive approaches. Up to 828 firms' data was collected via the Indonesia Stock Exchange's official website (www.idx.co.id) Because all study variables are latent variables that may be quantified using indicators, partial least squares (PLS) will be utilized in conjunction with SmartPLS software to process the data for the relationship between the variables. The inner model and the outer model are the two analytic models used in partial least squares. The relationship between variables and their measuring indications builds up the outer model. Meanwhile, the inner model is the relationship between the dependent variable and the independent variable.

RESULTS AND DISCUSSION

Descriptive Statistical Analysis

A descriptive analysis of the research variables can be summarized in the following table:

	BC	ISO	MO	AC	DER	AQ	EM
N	Valid	175	175	175	175	175	175
	Missing	0	0	0	0	0	0
Mean	,38339208	,73202455	,09252597	1,00000000	,73378810	,60000000	-,06403913
Median	,33333333	,77594300	,00001000	1,00000000	,56721018	1,00000000	-,02289895
Std. Deviation	,095191888	,196331721	,222179117	,000000000	,610781143	,491303684	,379454794
Minimum	,166667	,001875	,000000	1,000000	,065112	,000000	-2,124653
Maximum	,750000	1,000000	1,025090	1,000000	3,582672	1,000000	2,529680

Figure 1 . Descriptive Statistics

Variable X₁, namely Good Corporate Governance (GCG), consists of 4 reflective variables, namely Board of Commissioners, Institutional Share Ownership, Management Ownership and Audit Committee. In connection with all the companies studied already having an Audit Committee, the minimum and maximum values are 1. Therefore, the audit committee reflective variable must be removed from the calculation using Smart PLS.

Variable X₂, namely Leverage, is represented by the debt-to-equity ratio. The lowest Debt to Equity ratio is 0.06, and the highest is 3.58.

Variable X₃ is audit quality as measured by a dummy variable. Companies that are audited by Office of Public Accountant Big 4 have a dummy value = 1, while companies that are not audited by Office of Public Accountant Big 4 have a dummy value = 0. The majority of manufacturing issuers on the Indonesian Stock Exchange are audited by Office of Public Accountant Big 4, as seen by the average value of 0.6.

Variable Y in this research is Earnings Management. Profit management is calculated by first calculating total accruals, non-discretionary accruals, and then discretionary accruals.

Analysis of Construction Model Design

In this research, the researcher found that there were four problem formulations with four variables: 2 independent construction variables (X), 1 intervening variable, and one dependent construction variable (Y). Researchers first design the model structurally to understand the sequence of data tests. The structural model is shown below:

1. Convergent Validity

In SmartPLS, Convergent Validity is shown by the Outer Loading value (the absolute value of the outer raw loadings), which is presented in Structural Equation Modeling on the relationship line between the latent and manifest variables or in table form as follows:

	Audit Quality	Earnings Mana...	Good Corporat...	Leverage_
AQ	1.000			
BC			-0.488	
DER				1.000
EM		1.000		
ISO			-0.015	
MO			0.919	

Figure 2. Preliminary Convergent Validity

Test Results

Convergent Validity has met the criteria, shown by an outer loading value > 0.7 for all relationships between latent variables and reflective indicators (manifest). Because the Board of Commissioners and Institutional Shares do not have an outer loading > 0.7, which is indicated by a minus value, these two variables must be discarded. The PLS algorithm process is repeated by removing these two variables so that the results are as follows:

	Audit Quality	Earnings Mana...	Good Corporat...	Leverage_
AQ	1.000			
DER				1.000
EM		1.000		
MO			1.000	

Figure 3. Final Convergent Validity Test Results

The data tabulation above shows that Convergent Validity has been achieved because all outer loading values are > 0.7.

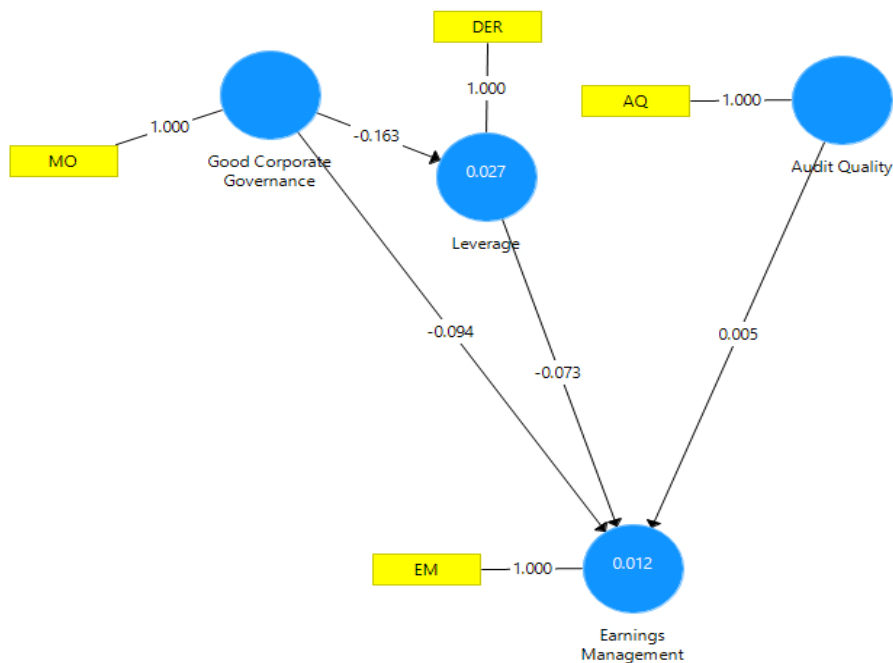


Figure 4. Convergent Validity

2. Composite reliability and average variance extracted (AVE)

If the composite reliability value is higher than 0.70, the construct is deemed reliable; otherwise, it is deemed legitimate if the AVE value is larger than 0.5. The following are the outcomes of the composite reliability and AVE values:

	Cronbach's Al...	rho_A	Composite Rel...	Average Varian...
Audit Quality	1.000	1.000	1.000	1.000
Earnings Mana...	1.000	1.000	1.000	1.000
Good Corporat...	1.000	1.000	1.000	1.000
Leverage_	1.000	1.000	1.000	1.000

Figure 5. Composite reliability and average variance extracted (AVE) test results

The table above shows that the AVE value is > 0.5 and Composite Reliability > 0.7.

3. Inner Model Testing

	R Square	R Square Adjus...
Earnings Management	0.012	-0.005
Leverage_	0.027	0.021

Figure 6. Test Results Inner Model

Inner Model value is measured using R- R-square latent variables with the same interpretation as regression. The results of measuring the Inner Model using PLS show that Leverage is influenced by GCG only by 2.7%. In comparison, earnings management is only influenced by 1.2% by Corporate Governance, which is mediated by leverage and influenced by audit quality.

4. Hypothesis test

In testing a hypothesis, the value that is analyzed is the value in the t-statistic, which is seen from the PLS results by comparing the t-table values. The PLS result is an aggregate linear model factor estimate. The following are the results of PLS Bootstrapping to test the research hypothesis as follows.

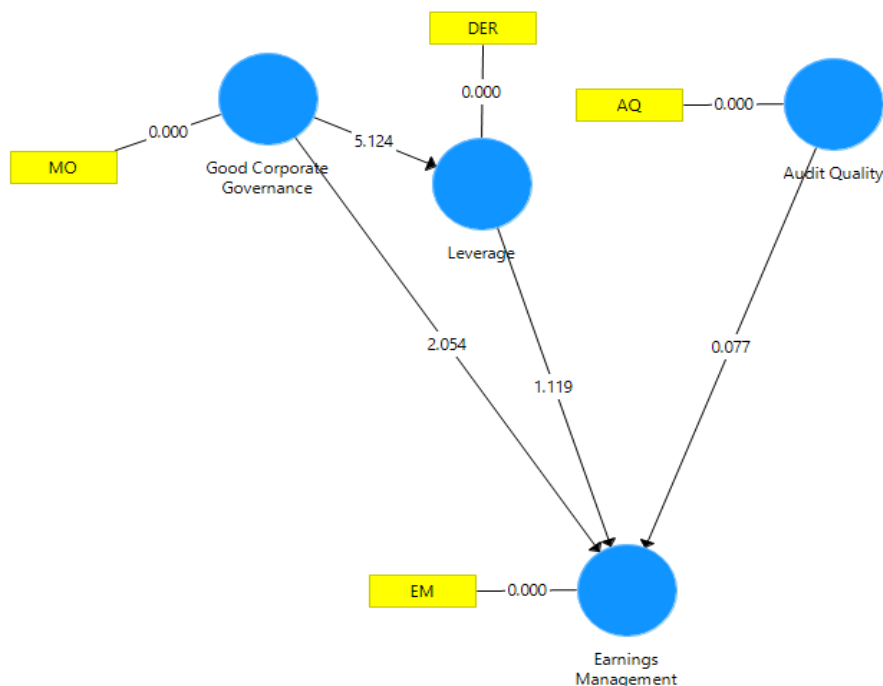


Figure 7. Results PLS Bootstrapping Test

Before testing the hypothesis in this research, the following will be presented in the form of a table of bootstrapping results, which explain the relationship and influence between independent and dependent variables.

	Original Sampl...	Sample Mean (...)	Standard Devia...	T Statistics (O/...	P Values
Audit Quality -> Earnings Management	0.005	0.004	0.070	0.077	0.939
Good Corporate Governance -> Earnings Management	-0.094	-0.095	0.046	2.054	0.040
Good Corporate Governance -> Leverage_	-0.163	-0.166	0.032	5.124	0.000
Leverage_ -> Earnings Management	-0.073	-0.072	0.065	1.119	0.264

Figure 8. Test Results bootstrapping

From the table above, it can be seen that the results of hypothesis testing are:

Hypothesis Testing 1:

Good Corporate Governance, represented by managerial ownership, has a significant influence on Leverage, namely a negative influence. These results are in accordance with research from (Kristianti & Setianingsih, 2022). The greater the management's share ownership, the lower the earnings management behavior carried out by company management. This allows management to effectively

select accounting methods that provide added value to the company. Managers who own shares in the company will have incentives to prepare high-quality financial reports. In this way, managers will monitor all parties in the company, thereby reducing earnings management behavior. The results of this research are in accordance with agency theory, which explains that managers as actors (agents) and investors as owners (principals) have different profit information objectives. Therefore, the greater the management share ownership ratio, the stronger the company's internal control is to monitor earnings management performance by internal parties.

Hypothesis Testing 2:

Leverage does not have a significant influence on Earnings Management. The results of this study contradict the results of Agustia and Suryani (2018) And Nalarreason et al. (2019). The more debt a company has, the harder it will try to improve the company's financial performance. If a company's financial performance does not reach the planned target, it will reduce creditors' confidence in the company. In addition, if the specified targets are not met, this can encourage managers to act opportunistically, namely reporting company profits higher than they should. The higher the leverage, the higher the value of a company's debt. Companies that have high leverage because their debt is greater than the assets owned by the company are suspected of carrying out earnings management practices because the company faces the threat of default, namely the inability to fulfill its obligations to pay debts on time. In this research, the results are different because some of the time in this research was carried out during the pandemic, namely 2020-2022 so all company conditions worsened in Indonesia and throughout the world. Therefore, Leverage has no influence on earnings management.

Hypothesis Testing 3:

Good Corporate Governance has a significant influence on Profit Management. The research results presented are different from the research conducted by (Bahri & Arrosyid, 2021). Managerial ownership has a negative effect on earnings management. Namely, the higher the managerial ownership, the lower the possibility of a company carrying out earnings management. This means that managers use the ownership they have to maintain their own interests. Beyond the amount of ownership a manager has, managers also tend to believe that they have free control over company information by hiding or avoiding true information. Managerial ownership has a negative effect on earnings management, namely a high level of managerial ownership can reduce negative earnings management behavior because managers are monitored to maximize profits for the benefit of shareholders. Therefore, managerial share ownership can reduce earnings management behavior in the company.

Hypothesis Testing 4:

Audit quality does not have a significant influence on earnings management. Audit quality does not affect earnings management. Auditor quality is related to the extent to which auditors detect fraud in a company. A good auditor is able to detect potential fraud, material overstatements, or understatements and find findings/evidence that support allegations of fraud. To carry out an audit, the auditor must carry out a series of procedures in accordance with ISA (International Auditing Standards), in this process the integrity, independence and professionalism of the auditor are very necessary, so that the auditor's financial report can be a truly good report and provide a fair opinion. The Big Four Office of Public Accountant's independent auditors are considered more capable and qualified in conducting audits because of their expertise, experience and good reputation. This shows that the higher the audit quality, the higher the earnings management behavior that can be prevented because Big Four Office of Public Accountant auditors are better able to detect potential fraud. However, this research gave the opposite results because the COVID-19 pandemic caused financial reporting anomalies that occurred during the 2020-2022 period.

	Original Sampl...	Sample Mean (...)	Standard Devia...	T Statistics (O/...	P Values
Good Corporate Governance -> Leverage_ -> Earnings Management	0.012	0.012	0.011	1.061	0.289

Figure 9. Test Results mediation

The results of the mediation test, according to the table above, show that Leverage cannot mediate the influence of Good Corporate Governance on Profit Management, which means that Leverage cannot carry out its role in mediating and the independent variable (Corporate Governance) can influence the dependent variable (Profit Management) directly.

CONCLUSION

From this research, it can be concluded that corporate governance has a significant influence on leverage. However, leverage does not influence earnings management. Corporate governance significantly influences earnings management, and audit quality does not affect earnings management. This research also has several limitations in its design or development, including economic conditions in 2020 - 2022 are in an anomalous state due to the COVID-19 pandemic, so all companies in Indonesia are affected by the pandemic storm, which causes company performance to be eroded. The reflective variables selected in each latent variable can be added to provide more comprehensive research results.

REFERENCES

- Agustia, Y. P., & Suryani, E. (2018). Pengaruh ukuran perusahaan, umur perusahaan, leverage, dan profitabilitas terhadap manajemen laba (Studi Pada Perusahaan Pertambangan yang Terdaftar di Bursa Efek Indonesia Periode 2014-2016). *Jurnal Aset (Akuntansi Riset)*, 10(1), 71–82.
- Al Saedi, A. A. (2018). Earnings management and its relationship with stock returns: an empirical study on a sample of Qatari listed industrial companies. *Academy of Accounting and Financial Studies Journal*, 22(5), 1–12.
- Albert, A., & Widyastuti, E. (2019). Analisis pengaruh kualitas audit, leverage, dan kepemilikan manajerial terhadap manajemen laba (Studi empiris pada perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia tahun 2015--2017). *BALANCE: Jurnal Akuntansi, Auditing Dan Keuangan*, 16(1), 21.
- Bahri, S., & Arrosyid, Y. P. (2021). Struktur Kepemilikan, Good Corporate Governance, Leverage, Dan Ukuran Perusahaan Terhadap Manajemen Laba. *RISTANSI: Riset Akuntansi*, 2(1), 59–77.
- Fionita, Y., & Fitra, H. (2021). Pengaruh kepemilikan institusional, komisaris independen, komite audit, pertumbuhan penjualan, dan leverage terhadap manajemen laba. *Jurnal Eksplorasi Akuntansi*, 3(4), 893–907.
- Hadi, F. I., & Tifani, S. (2020). Pengaruh kualitas audit dan auditor switching terhadap manajemen laba. *Jurnal Bisnis Dan Akuntansi*, 22(1), 95–104.
- Indarti, M. G. K., & Widiatmoko, J. (2021). The effects of earnings management and audit quality on the cost of equity capital: empirical evidence from Indonesia. *The Journal of Asian Finance, Economics and Business*, 8(4), 769–776.
- Kristianti, I., & Setianingsih, A. (2022). Pengaruh Manajemen Laba dan Tata Kelola Perusahaan Terhadap Audit Delay. *Owner: Riset Dan Jurnal Akuntansi*, 6(2), 1621–1632.
- Nalarreason, K. M., Sutrisno, T., & Mardiyati, E. (2019). Impact of leverage and firm size on earnings management in Indonesia. *International Journal of Multicultural and Multireligious Understanding*, 6(1), 19–24.
- Prihatiningtyas, D. (2018). Pengaruh Mekanisme Good Governance, Ukuran Perusahaan dan Leverage terhadap Manajemen Laba. *Skripsi. Universitas Muhammadiyah Surakarta*.

- Qomariyah, H. (2018). Pengaruh Ukuran Dewan Komisaris, Leverage Dan Ukuran Perusahaan Terhadap Manajemen Laba Dengan Kualitas Audit Sebagai Variabel Moderasi. UIN SUNAN KALIJAGA YOGYAKARTA.
- Savitri, D., & Priantina, D. (2019). Pengaruh leverage terhadap manajemen laba dengan corporate governance sebagai variabel pemoderasi pada perusahaan manufaktur sektor aneka industri yang terdaftar di BEI periode 2013-2016. *Nominal Barometer Riset Akuntansi Dan Manajemen*, 8(2), 179–193.
- Tarigan, M. O. T., & Saragih, A. E. (2020). Pengaruh Kualitas Audit Terhadap Manajemen Laba Apada Perusahaan Perbankan Yang Terdaftar Di Bursa Efek Indonesia. *Jurnal Riset Akuntansi & Keuangan*, 185–206.
- Wardani, A. V. T. (2018). Pengaruh Ukuran Perusahaan, Pajak Penghasilan, Good Corporate Governance, dan Leverage Terhadap Manajemen Laba.
- Wijayanti, A., Wijayanti, A., & Siddi, P. (2021). Pengaruh Perencanaan Pajak, Kualitas Audit Dan Gcg Terhadap Manajemen Laba. *Jurnal Ilmiah Manajemen, Ekonomi, & Akuntansi (MEA)*, 5(2), 1816–1834.



© 2023 by the authors. It was submitted for possible open-access publication under the terms and conditions of the Creative Commons Attribution (CC BY SA) license (<https://creativecommons.org/licenses/by-sa/4.0/>).