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The Effect of Corporate Governance on Profit Management

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Abstract: This study aims to determine the effect of corporate governance as measured by an independent board of commissioners, board size of managerial ownership and board diversity on earnings management . The collection used the purposive sampling method so that a total of 58 JII and NON JII companies were obtained for the 2014-2017 period. The data analysis technique used in this study was a quantitative method, then the data was classified into certain categories and with certain tables, in this study using the application *STATA 12* . The results of this study indicate that there are factors that can predict the occurrence of earnings management in a company with an independent board of commissioners, *board size,* managerial ownership, and *board diversity* in both companies listed on JII and non-JII.

Keywords: Corporate Governance, Profit Management, Board Size, Board Diversity .

INTRODUCTION

Profit is an illustration of company performance that can be managed properly and efficiently. The point is to increase profits as expected and can provide benefits for certain parties, and also be managed efficiently to increase the informativeness of information within the company. To see can see from the company's profit, financial statements are needed to see from the profit or loss of the company.

Financial statements are a source of information used to assess the financial position and performance of a company for external parties. One important part of the financial statements is to measure the performance of management, namely profit. Profit information is the main concern in seeing the performance or achievements of management.

According to Scott (2011) said that earnings management is a decision made by managers to choose certain accounting policies that are considered to be able to achieve the expected goals, both to increase profits and reduce the level of reported losses. Meanwhile, according to Anggraeni and Hadipratijno (2013) states that earnings management occurs when management uses certain decisions in financial reporting and the preparation of transactions that change financial statements, this aims to mislead stakeholders about the condition of the company's economic performance, as well as influence the income of contracts that control reported accounting numbers.

The conclusion from the definition above is that management does earnings management over the selection of existing accounting policies. The existence of earnings management actions is based on several behaviors from management. First, opportunistic management behavior that aims to maximize its utility against compensation, contracts, and political costs. Second, earnings management does so to benefit all parties involved in the contract from a contract perspective.

Earnings management for academics can be considered as a professional judgment on financial statements. This action can mislead users of financial statements by presenting inaccurate information. It can even be used as a cause for committing illegal acts. For example, in the presentation of financial reports that are distorted or not in accordance with the truth.

In order to avoid earnings management practices by management in a company, good corporate governance is needed in controlling and managing the company. With the existence of corporate governance, it will be able to overcome agency conflicts. If this concept can be implemented properly, economic growth will continue to increase with the transparency of company management which is getting better and can benefit many parties. The Indonesian Institute for Corporate Governance (IICG) defines the concept of corporate governance as a series of mechanisms directed and controlled by a company so that the company's operations run according to the expectations of stakeholders.

The National Committee on Governance Policy or KNKG states that corporate governance can work effectively if it can be carried out in a transparent, accountable, fair and responsible manner. Transparency is related to the quality of information submitted by the company to interested parties in an accurate and timely manner. Accountability, which is related to the role of the board of directors and the board of commissioners in carrying out their duties optimally and professionally. Fairness, related to efforts to protect rights that are carried out optimally and also fair treatment to all shareholders without exception. Responsibility, which relates to the optimal role of stakeholders in supporting the company's work program.

The current development of the Indonesian capital market is not only the Jakarta Composite Index (IHSG) which is used as a benchmark for investors, but also the JII (Jakarta Islamic Index) which is used as a benchmark for sharia-based capital markets. JII shares are stocks where all issuers and their products comply with the sharia concept. Efficiency and supported by various institutions or professions supporting the Islamic capital market (Nurlatifah, 2015). Talking about earnings management is very interesting if a study is carried out on earnings management practices in companies that are members of the Jakarta Islamic Index (JII). This is based on the reason that earnings management is an area that can be said to be a controversial area. Earnings management activities can be viewed from two different perspectives, namely as wrong actions (negative) and actions that management takes are positive.

Companies that are included in Non-JII are companies that are not included in the criteria of JII or can also be called conventional markets. The general difference between sharia-based capital markets and conventional-based capital markets lies in the instruments and transaction mechanisms, while the difference between the sharia stock index values and conventional index values lies in the criteria that must be met . The criteria used by JII are the criteria set by the National Sharia Council No. 40 of 2003, related to issuers, indexes, and JII index entry requirements.

Based on research results obtained from previous studies conducted by researchers. So this research is expected to provide a conceptual contribution to the development of earnings management literature. Therefore the authors conducted research with the title " **The**

Influence of Corporate Governance on Profit Management in Companies Registered on JII (Jakarta Islamic Index) and NON JII"

LITERATURE REVIEWS

Profit Management

In showing the size of the company's performance and profit strength in the future, in an organization, the company's business is determined by the profit generated by the company. And also profit figures are also used as a form of the company in making decisions in a company's business.

Earnings management until now there is still no agreement on its definition. There are some parties who define earnings management as fraud that has been carried out by a manager to trick other people, besides that there are also parties who define it as an activity that is normally carried out by a manager in preparing financial reports. According to Warmadewa (2010) said that earnings management as a process takes deliberate steps within the limits of generally accepted accounting principles to produce the desired level of profit. According to Wahyono (2011) earnings management is a deliberate attempt by management to manipulate financial statements within the limits permitted by accounting principles with the aim of providing misleading information to users of financial statements.

Based on the above definition, it can be concluded that earnings management is an activity carried out by management which is carried out intentionally to manipulate financial reports with the aim of personal gain within the limits permitted by accounting principles and also to provide misleading information to users of financial statements. And also Earnings management can be said as an action that can reduce the quality of financial reports.

Corporate Governance

There are many definitions of Corporate Governance. The Forum for Corporate Governance in Indonesia (FCGI) defines corporate governance as a set of regulations that can regulate the relationship between shareholders, share managers, creditors, the government, employees and other internal and external stakeholders that are related to their rights and obligations. to manage and control the company.

According to the National Committee on Governance Policy, corporate governance is a process and structure that can be used by company organizations in order to provide added value to the company in a sustainable manner in the long term for shareholders, while taking into account the interests of other stakeholders, which is based on laws and regulations and applicable norms.

Widiyatmaja (2010) states that there are two things of concern in corporate governance. The first is the importance of the rights of shareholders to obtain correct, accurate and timely information, and the second is the company's obligation to make accurate, timely and transparent disclosures regarding all information on company performance, ownership and stakeholders. The point is that in corporate governance the things that must be considered are by providing information to shareholders in an accurate, timely and also transparent manner regarding company performance information assigned by company leaders.

In implementing good corporate governance, company management needs to apply some of the principles of good corporate governance which aim to make the company able to run in a sustainable manner and be able to benefit stakeholders.

Board Size

The term "Board size" is a term that refers to the number of board members in a company (Appuhami & Bhuyan: 2015). Agency theorists identify two main problems associated with larger board sizes that can result in agency problems: 1. There are problems with board communication and coordination. 2. The inability of the board to control management.

Corporate Governance in Indonesia separates the board of commissioners from the board of directors. The board of commissioners has the function of overseeing and providing advice to managers on behalf of the shareholders. In the company's internal control system, the board of commissioners as the top has an important role in supervisory activities (Widiatmaja, 2010). Monitoring carried out by the commissioners will add to the confidence that management has acted in accordance with the interests of the shareholders, because the boards of commissioners are appointed by the shareholders, they must represent the interests of the shareholders in supervising management's actions.

On the other hand, there are disputes between internal managers and oversight of management policies and providing advice to management, an independent third party is needed. An independent commissioner is the best position to carry out these functions in order to create a company that has good corporate governance.

Board Diversity

Normal corporate governance consists of at least a board of commissioners, directors and also an audit committee. The three committees have the possibility of consisting of various individual structures or compositions. The concept of diversity is the variation of social and cultural identities between groups of people in the context of employment or markets, social and cultural identification is defined as personal affiliation with groups which in this study was shown to have a significant influence on the main life experience of the person, age group and work specialization, among others (Marimuthu, 2015).

There are 2 forms of diversity from board diversity, namely demographic diversity and status diversity, demographic diversity includes gender diversity, country and director positions, while status diversity includes independence, leadership status, and ownership (Amar et al, 2009). According to Marimuthu (2015) board diversity can be seen from demographic diversity and cognitive diversity which includes knowledge, education, values, perceptions, characteristics and personal traits.

Board diversity is one of the keys to optimizing organizational resources, because good implementation will be able to manage management well too. The diversity of company leaders, especially from gender, will have different effects on earnings management. These differences can be seen from the decisions taken by managers.

METHODS

The research design used in this research is comparative research, namely a type of research conducted to find answers about cause and effect, by analyzing the causal factors that occur or appear in a particular phenomenon. So comparative research is research conducted to use a comparison of two or more groups of certain variables. This research is also classified as *hypothesis* testing, because this study aims to explain certain relationships, namely whether or not the effect of *corporate governance* is proxied by an independent board of commissioners, *board size* , managerial ownership, and *board diversity* on earnings management. The data used in this study is quantitative data whose purpose is to analyze the effect of *corporate governance* on earnings management in JII and Non-JII companies in 2014-2017.

The data analysis technique used in this study is the quantitative method, where the quantitative method is a form of analysis that uses numbers and calculations using statistical methods, then the data is classified into certain categories and with certain tables, in this study using the STATA 12 application . . The analytical tool used in this research is panel data regression analysis.

In order to get good results by using *time series* and *cross section analysis* , panel data analysis can be used. This analysis has various advantages that are not found in *time series* or *cross section analysis* .

RESULTS AND DISCUSSION

The Effect of Each Variable on Earnings Management at JII Companies

1. The Influence of the Independent Board of Commissioners on Earnings Management

    The results of this study indicate that the independent board of commissioners that has been measured has a positive coefficient value of 0.216 with a significant level of 0.076 which is greater than 0.05. This shows that the independent board of commissioners has no significant negative effect on earnings management or in other words H1a is rejected.

    In this case the independent board of commissioners is possible only as a fulfillment of the needs of the regulator of the company which cannot supervise the company's management and also does not have the authority to make decisions, if there are differences or are not in line with the owner's decision, the owner can replace the independent board of commissioners. The addition or placement of independent commissioners is only to comply with formal requirements, while the majority shareholder still plays an important role so that the performance of the board does not increase or even decrease. This study supports previous research by Veronica and Utama (2005), Sochib (2015), Kusumawati, et al (2013) and Indriastusi (2012) which stated that an independent board of commissioners has no effect on earnings management.

2. Effect of Board Size on Earnings Management

    The results of this study indicate that Board Size as measured by the board of commissioners has a positive coefficient value of 0.005 with a significant level of 0.385 which is greater than 0.05. This shows that the board of commissioners has no significant negative effect on earnings management or in other words H2a is rejected.

    Based on the results that have been tested in this study, it can be proven that the size of the board of commissioners in a company is not the main determining factor in the effectiveness of oversight of company management. This research is in accordance with previous research conducted by Wahyuningsih (2009) which states that the size of the board of commissioners has no effect on earnings management. This statement is also supported by Eka Sefiana (2009), Sochib (2015) and also Suryani (2010) that the size of the board of commissioners has no effect on earnings management.

3. The Effect of Managerial Ownership on Earnings Management

    The results of this study indicate that managerial ownership has a positive coefficient value of 0.457 with a significant level of 0.648 which is far greater than 0.05. This shows that managerial ownership has no significant positive effect on earnings management or in other words H3a is rejected.

    The results of this study contradict several theories regarding high managerial ownership which can lead to *corporate governance* which can reduce earnings management activity. In this case it can be indicated that the research sample used has a low amount of managerial ownership. Therefore, the results obtained are less effective in showing managerial ownership influencing earnings management. These results are the same as previous studies examined by Kusumawati, et al (2013) which stated that managerial ownership has no effect on earnings management practices. This result is consistent with the results of Dewi and Khoiruddin (2016) who say that managerial ownership does not affect earnings management.

4. Effect of Board Diversity on Earnings Management

   Individually the independent variable *board diversity* is the presence of women on the board of directors proxied by the *dummy variable* (value 1 if there are women on the board of directors, value 0 if there are no women on the board of directors). The results of this study indicate that *Board Diversity* as measured by gender of the directors has a negative coefficient of -0.116 with a significant level of 0.002 which is less than 0.05. This shows that *Board Diversity* has a significant negative effect on earnings management or in other words H4a is accepted.

   This study is consistent with previous research by Barua, et al (2010) which stated that female CFOs have a negative effect on earnings management. This can be interpreted that the existence of women in the ranks who play an important role in a company, both in the directors. Because women are known to be more careful and more risk averse than men. That way the presence of women in the board of directors can reduce the level of earnings management in a company.

The Influence of Each Variable on Profit Management in Companies Registered on Non-JII

1. The Influence of the Independent Board of Commissioners on Earnings Management

   The results of this study indicate that the independent board of commissioners that has been measured has a negative coefficient value of -0.092 with a significant level of 0.262 which is greater than 0.05. This shows that the independent board of commissioners has no significant negative effect on earnings management or in other words H1b is rejected.

   The existence of an independent board of commissioners does not have an effective influence on oversight of management in the company. This study is consistent with previous research by Sochib (2015), Kusumawati, et al. (2013) and Veronica and Siddharta (2005) and Guna and Herawaty (2009) who state that an independent board of commissioners has no effect on earnings management .

2. Effect of *Board Size* on Earnings Management

   The results of this study indicate that *Board Size* as measured by the board of commissioners has a negative coefficient of -0.001 with a significant level of 0.784 which is greater than 0.05. This shows that the board of commissioners has no significant negative effect on earnings management or in other words H2b is rejected.

   Therefore, the size of the board of commissioners has no effect on earnings management activities. Previous research also examines the same matter by Wahyuningsih (2009) which states that the size of the board of commissioners has no effect on earnings management. This statement is also supported by Eka Sefiana (2009) and Sochib (2015) that the size of the board of commissioners has no effect on earnings management.

3. The Effect of Managerial Ownership on Earnings Management

   The results of this study indicate that managerial ownership has a negative coefficient of -0.00004 with a significant level of 0.957 which is greater than 0.05. This shows that managerial ownership has no significant negative effect on earnings management or in other words H3b is rejected.

   Managerial ownership does not have a significant effect on earnings management because managers or directors own relatively very small shares when compared to the total capital owned by general investors. It can also be concluded that managerial ownership is not capable of being a *corporate governance mechanism* that can reduce the misalignment of interests between management and owners and shareholders. These results are the same as previous studies examined by Kusumawati, et al (2013) which stated that managerial ownership has no effect on earnings management practices. This result is consistent with the results of Dewi and Khoiruddin (2016) who say that managerial ownership does not affect earnings management.

4. Effect of Board Diversity on Earnings Management

The results of this study indicate that *Board Diversity* as measured by gender of the directors has a positive coefficient value of 0.008 with a significant level of 0.676 which is greater than 0.05. This shows that *Board Diversity* has no significant positive effect on earnings management or in other words H4b is rejected.

In this case there is no influence from the female gender in the board of directors who can supervise the company's management. This study agrees with previous research by Trivadi and Huang (2011) that *board diversity* has no effect on earnings management. The absence of influence on the presence of women in the board of directors is thought to be caused by the characteristics of women themselves, which in general are less fond of risk than men. Therefore women have a lower presentation in several positions than men (Charness and Gneezy, 2007)

CONCLUSION

Based on the results of the data analysis and discussion described above, it can therefore be concluded that the results of testing the first hypothesis (1) in JII and Non-JII companies indicate that the board of independent commissioners has no significant negative effect on earnings management, the second hypothesis (2) on JII and NON JII companies show that *board size* as measured by the board of commissioners has no significant negative effect on earnings management, the third hypothesis (3) in JII companies shows managerial ownership has no significant positive effect on earnings management, fourth hypothesis (4) , in companies registered on JII it shows that *board diversity* as measured by the gender of women in directors has a significant negative effect on earnings management.

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