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Board Characteristics and Earnings Management

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ABSTRACT

The purpose of this study is to examine the impact on earnings management as the dependent variable of board size, board independence, frequency of board meetings, board expertise, audit committee size, independence, frequency of audit committee meetings, and audit committee skills in finance and accounting. This research method is quantitative. This study uses time series data. The sample of this research is the financial statements from 2018 to 2022, which covers more than one period. The population of this study is non-financial sector companies listed on the Indonesia Stock Exchange during the 2018-2022 period, with the sampling technique using purposive sampling method. The results showed that the independence of the board of directors, the frequency of board meetings, the independence of the audit committee, and the frequency of audit committee meetings had a significant positive effect on earnings management. Meanwhile, board size, board expertise, audit committee size, and audit committee skills in finance and accounting do not show a significant relationship with earnings management.

Keywords: Audit Committee Characteristic, Board Characteristic, Earning Management

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INTRODUCTION

Revenue shows how the company's financial performance and growth prospects, thus motivating business partners to assess the productivity seen in the financial statements. To assist various parties in making decisions, financial statements are created to provide information about a company's performance, financial situation, and changes in that position. In order for shareholders and other stakeholders to track the company's profitability and make informed investment decisions, the company must provide comprehensive financial statements (Yosifa et al., 2021). The pursuit of large profits encourages earnings management, or the management of earnings in a company's financial statements, where the usefulness or value of the business is designed to be optimized in the financial statements. The management practice of raising or lowering earnings on financial statements to achieve specific goals is known as earnings management (Setiawan, 2018). This behavior is very detrimental to users of financial statements because the information reflected in the financial statements does not match the actual situation. According to (Scott, 2019) Three approaches can be used to manage earnings: 1) take advantage of opportunities to adjust accounting estimates; 2) change accounting practices; and 3) delay recognition of costs or revenues. Large earnings attract investors because they offer a higher rate of return. In other words, assets will be more productive in generating net income if the rate of return is high (Taco, 2016).

Examples of negative management cases such as the case of PT Garuda Indonesia, where in early 2019 PT Garuda Indonesia was found to have manipulated revenue during the 2018 accounting period. The company was found to manipulate revenue by recognizing unearned income of $239,940,000. Manipulation is deliberately carried out by managers ignoring the board to make performance look better than the previous year. Earnings management actions have certainly caused financial instruments to be unable to function as guidelines in decision making. The decision-making process needs to be carried out with corporate governance as one of the prerequisites for good and healthy organizational management, which can reduce or eliminate earnings management activities (Firnanti et al., 2019). The existence of a board of directors and other forms of governance exist, the audit committee will encourage management to convey correct company information.

In addition to preventing poor management practices that could spark controversy or lead to corporate failure, board members should also ensure the organization capitalizes on opportunities to enhance the value and well-being of all stakeholders. The findings show that the size of the audit committee and the board of directors have a negative impact on earnings management. This means that the audit committee can prevent managers from falsifying financial statements, and the board of directors will increase the supervisory role of management to reduce earnings management practices.

Companies can reorganize the parties involved in financial management, such as the board of directors, commissioners, and audit committee, whose role is to encourage management to submit accurate financial reports, in order to reduce or eliminate earnings management methods (Setiawan, 2018). In monitoring management performance and the accuracy of the information in the financial accounts, the board of directors plays a crucial role (Halila et al., 2022). Earnings management practices can be curtailed by the influence of certain parties, though the pressure placed on directors can also drive such practices..

This study replicates research by Rajeevan & Ajward (2019), using a sample of Indonesian companies from the non-financial sector listed on the Indonesia Stock Exchange (IDX) with a period of 2018 to 2022. The variables considered in this study include the size, independence, financial expertise, and frequency of board of commissioners meetings; the size, independence, and financial expertise of the audit committee; and the frequency of audit committee meetings. The control variables used are Big Four internal audit, company size, leverage, and sales growth. The theoretical benefit of this research is to expand understanding in the field of management accounting, especially regarding the awareness of investors, stakeholders, and other parties in the company about the factors that influence the development of the company and the potential for fraud. It is expected that this research will practically give investors, stakeholders, and other parties of the company a reason to improve the quality of financial data. In addition, this study can serve as a reference for other research on the variables that influence the likelihood of fraud in organizations, especially those related to board traits and earnings management. From a policy perspective, the results of this study are expected to be considered by both internal and external parties of the company when making policies related to the quality of financial information. This is aimed at enhancing the quality of the company's financial statements.

The purpose of this study is to investigate how the quality of the audit committee and the board of directors affects earnings management.

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LITERATURE REVIEW

Earnings Management

In reality, earnings management occurs in two ways: first, by manipulating accruals, particularly discretionary accruals which is done by modifying the deferral period; and second, by manipulating actual activities, such as procurement, production, sales, and administrative tasks (Octavia, 2017). Based on research conducted by (Firnanti et al., 2019), the decision of company managers to use certain accounting procedures that allow the organization to meet its objectives is reflected in earnings management. Executives can perform earnings management to maintain excellent business performance and meet certain personal contractual objectives related to the company's financial statements when there is a relationship between tax measurements and financial statements. Companies may also use earnings management to lower profit taxes.

Size of the Board of Directors

The board of directors is a group of people appointed to oversee, be responsible for the company's operations and act in accordance with the company's objectives. Board size is measured based on the number of boards in the company (Pratama et al., 2022). Based on Cho & Chung (2022) research, there is a positive and significant impact. In particular, a smaller board size is more effective in reducing earnings management activities and increasing firm value, which increases effectiveness and reduces the likelihood of managers engaging in earnings management. In contrast, a larger board makes it more difficult for management to unify their opinions and ideas and results in reduced management monitoring (Rinta, 2021). Based on the literature, the first hypothesis is:

H1: Board size has a positive effect on earnings management.

Independent Board of Directors

The company's top managers and outside, independent members—who are presumed to represent shareholders and have no other affiliation with the company—make up the board of directors. Based on (el Diri et al., 2020) research, there is a positive significant relationship with earnings management because the more independence of members, the stronger the disciplinary role on managers so that they can avoid colluding to deceive shareholders. Based on the literature, the second hypothesis is:

H2: Independent board of directors has a positive influence on earnings management

Board of Directors Meeting

Board meetings aim to discuss company issues. The number of board meetings is a metric of board activity and is frequently used as a proxy for the efforts of the directors. The number of meetings that the majority of board members attend each fiscal year provides information about it. Empirical studies verify that the quality of audit work, board effectiveness the intensity of board activities, and revenue generation can be related to the number of board meetings held (Habbash, 2019). Based on the literature, the third hypothesis is:

H3: Board meetings have a positive influence on earnings management

Board Expertise

The expertise of the board of directors can effectively prevent earnings management actions, so that the earnings reported to stakeholders are transparent (Mardianto & Chintia, 2022) with the aim of avoiding asymmetric information in the company requires the concept of good corporate governance, this will ensure that the company has a high level of transparency, accountability, responsibility, independence, and fairness. Based on the literature, the fourth hypothesis is:

H4: The expertise of the board of directors has an influence on earnings management

Audit Committee Size

The board of directors, the internal control framework and the external auditors are formally connected through the audit committee. The presence of an audit committee is expected to reduce or prevent fraudulent acts committed by company managers. There are controversial views on the

number of supervisory board members, with some arguing that supervisory boards with less than three members do not perform well in supervision (NGO & LE, 2021). Based on the literature, the fifth hypothesis is:
H5: Audit committee size has a positive influence on earnings management.

Independent Audit Committee
The independence of non-executive directors who are on the audit committee is seen as one of the important factors contributing to the effectiveness of corporate governance (Habbash, 2019), thus limiting the possibility of earnings management. A fully independent Audit Committee protects the interests of shareholders well and oversees objectively the performance of supervisory members of the board of directors well. Based on the literature, the sixth hypothesis is:
H6: Independent Audit Committee is significantly positive to earnings management.

Audit Committee Meeting
An important objective of audit committees is that members have sufficient time to perform their responsibilities of monitoring financial reporting processes also argue that audit members who meet more frequently can effectively perform their oversight role. Sajjad et al (2019) say that audit committee meetings at least four times per year are negatively associated with directors' earnings. Based on the literature, the seventh hypothesis is:
H7: Audit Committee Meetings are significantly positive to earnings management.

Audit Committee Expertise
The purpose of the audit committee's oversight function is to ensure and improve the accuracy of financial statements. As a result, audit committees that have members with finance and accounting backgrounds will function more effectively and be better able to identify and stop earnings manipulation (Pratama et al., 2022). Based on the literature, the eighth hypothesis is:
H8: Audit Committee Expertise has an influence on earnings management.

METHODS

This research method is quantitative. The data sources to be used in this research are obtained indirectly, which is often referred to as secondary data. The purpose of this research is to develop theories that have been applied in previous studies. This study uses time series data, because the research sample is collected based on a period of time through financial reports published on the company's website or on the IDX. This research sample is financial statements from 2018 to 2022, which covers more than one period. The study's population consists of non-financial sector companies that were listed between 2018 and 2022 on the Indonesia Stock Exchange. Purposive sampling was used as the sampling strategy. Samples were chosen according to the following standards :

1. Non-financial companies listed on the IDX from 2018 to 2022,
2. Exclude financial companies listed on the IDX,
3. The financial statements used must contain variable data relevant to the research.

Table 1. Research Sample Criteria

Description	Total
Number of companies listed on the IDX 2018 - 2022	868 companies
Number of companies that do not meet the criteria	466 companies
Companies that can be processed as samples	402 companies
Number of years of research	5 year
Total data that meets the criteria	2010 data
Number of Outlier data	175 data
Total data free from outliers	1835 data

Source: Data Processed, (2023)

The operational definitions and measurements for each research variable are as follows:

Table 2. Operational definitions and variable measurements

Variables and Denotations	Measurement
Dependent Variable	
Real Earning Manajemen (REM)	The dependent variable of this study is management income measured using; cash flow from operating activities, based on production costs and based on the cost of expenses.
Independent Variable	
Board Size (BSIZE)	Based on the number of boards of directors in the company and the period underway
Board Independency (INDBD)	Number of independent directors in the company
Board Meeting (BMEET)	Number of meeting activities held by the company in the ongoing year
Board Expertise (BEXP)	Number of board members who have qualifications in accounting and finance within the company
Audit Committee Size (AUDSIZE)	Number of audit committees in the company and the period underway
Audit Committee Independency (INDAC)	Number of independent audit committees in the company
Audit Committee Meeting (ACMEET)	Number of meeting activities held by the company in the ongoing year
Audit Committee Skill Base in Finance and Accounting (ACFEXP)	Number of board members who have qualifications in accounting and finance within the company
Control Variables	
Leverage (LEV)	The proportion of the company's total assets at the conclusion of the current period to its total debt at the end of the previous one.
BIG4 (BIG4)	Code "1" if audited by Big4 and Code "0" if not audited by Big4.
Firm Size (FSIZE)	Natural logarithm of total assets
Sales Growth (GROWTH)	Sales growth of company i form period t-1 to t

Source: (Rajeevan & Ajward, 2019)

Testing the research hypothesis is the purpose of this data analysis. To fulfill the data requirements of the study, an outlier test was conducted at the beginning of this study. The best model was then selected using a combination of descriptive statistical analysis and Chow, Hausman, and Lagrange Multiplier (LM) tests. Using Eviews10, F, t, and coefficient of determination (R^2) tests were conducted once the research model was established.

RESULTS AND DISCUSSION

Outlier Test

Studentized Deleted Residue (SDR), which falls outside the range of -1.960 to 1.960, is used in the outlier test to identify data features that are different from the rest of the data. The remaining businesses that met this requirement were 1835 data over a five-year period, from 2018 to 2022.

Descriptive Statistics Test

Table 3. Descriptive statistical test results

Descriptive Statistics					
Variable	Data	Minimum	Maximum	Mean	Std. Deviation
Real Earning Management		-1,9312	1,37107	0,0078	0,3674
Board Size	1835	2,0000	14,0000	4,7090	1,8730
Independence of the Board of Directors	1835	1,0000	8,0000	8,6740	0,1647
Board of Directors Meetings	1835	6,0000	50,000	12,270	5,8045
Board of Directors Expertise	1835	2,0000	5,0000	2,5300	0,7521
Audit Committee Independence	1835	1,0000	3,000	0,1020	0,1721
Audit Committee Size	1835	3,0000	5,0000	0,3234	0,2869
Audit Committee Expertise	1835	1,0000	5,0000	0,2320	0,7565
Audit Committee Meeting	1835	2,0000	20,000	6,2100	3,1273

Source: Processed Secondary Data (2023)

Descriptive statistical results provide information about the number of samples, minimum value, maximum value, average, and standard deviation. Table 3 shows that the reported REM has a range of values between -1.93 and 1.37, with an average of 0.007. This suggests that some companies actually control their earnings. As the value of observed earnings management increases, so does the risk associated with true activity-based earnings management in a company. This is the result of unusual actions taken by the company in its business endeavors to control earnings within a certain period of time.

The board size variable shows a minimum value of 2, which means that in the company there are 2 members of the board of directors. The average board size is 4.709, which indicates that the average company listed on the IDX has between 4 and 5 members of the board of directors. This shows that companies on the IDX have complied with the provisions of the Law of the Republic of Indonesia Year 2007 Article 92 Paragraph (5), which stipulates that the board of directors must consist of at least 2 people.

Meanwhile, the independent board of directors variable shows a minimum value of 1.0000, which means there are companies with only 1 independent board member. On the other hand, the maximum value reaches 8.0000, indicating the existence of companies where the majority of board members are independent members. The average value for the independent board of directors is 0.1674 or 16.74%, meaning the average company on the IDX has 1 or 2 independent board members.

For the board of directors meeting variable, the minimum value is 6.0000, which means that the company holds at least 6 meetings a year. While the maximum value is 50,000, as recorded at PT Astra Agro Lestari in 2020 and 2021. The average number of board meetings is 12.270, indicating that companies hold around 12 meetings on average each year.

Table 4. Descriptive statistical test results of dummy variables

Variable	Category	Frequency	Percentage
Auditor Eksternal	0=NonBig4	1,203	65,6
	1=Big4	632	34,4

Source: Processed Secondary Data (2023)

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Based on the data contained in Table 2, the percentage of samples using Non-Big4 KAP reached 1,203 data, or 65.6% of the total sample. In contrast, the use of KAP Big4 was recorded as much as 632 data, which is equivalent to 34.4% of the total sample. This shows that most companies do not use the services of KAP Big4. On the other hand, auditors from Big4 KAP have a reputation for high quality competence in auditing, which allows them to control earnings management more effectively in the company.

Panel Data Regression Model Selection

Choosing the right model for panel data regression technique is a step that must be done before the hypothesis is tested. The Hausman and Chow tests can be used to select the right model. Possible panel regression results include pooled least square (PLS), fixed effect model (FEM), and random effect model (REM).

Chow Test

Chow analysis is conducted to choose between the Pooled Least Squares (PLS) model and the Fixed Effect Model (FEM). If the significance value of the Chow test is less than 0.05, the FEM model is more appropriate. In your case, the significance value of 0.0000 indicates that the FEM is more suitable for the data you analyzed. Thus, you conclude that the most appropriate research model is the Fixed Effect Model (FEM).

Table 5. Chow test results

Effects Test	Statistic	Prob.	Description
Cross-section F	9.769689	0.0000	*Fixed effect model*
Cross-section Chi-square	489.803628	0.0000	

Source: Secondary data processed (2023)

Hausman test

Fixed effect model (FEM) or Random effect model (REM) is the optimal model selection in the Hausman test. The optimal model is shown by REM if the probability value is ≥ 0.05. On the other hand, FEM is the most appropriate model if the probability value is <0.05. Given the probability value of 0.0030, it can be said that, in this study, the FEM Random effect model (REM).

Table 6. Hausman test results

Test Summary	Chi-Sq. Statistic	Prob.	Description
Cross-section random	6.902303	0.0300	*Fixed effect model*

Source: Secondary Data processed (2023)

Hypothesis Testing

F test

The test criterion is if the probability value <0.05 then the F test is considered significant, which indicates that the independent variable has a stimulant effect on the dependent variable. The test results can be seen in table 7:

Table 7. F Test Results

Dependent variable	Model	Prob
Real Earning Management	Fixed Effect Model	0,000

Source: Processed Secondary Data (2023)

Based on Table 7, real earnings management is significantly influenced by the independent variables.

T-test

The test criterion is if the probability value of the t test> 0.05, then the independent variable has a partially significant impact on the dependent variable.

Table 8. The result of t test

Variable	Coefficient	t-Statistic	Prob.	Description
C	-0,5725	-1,9653	0,0505	
Board Size	-0,0095	-0,2203	0.8258	Not significant

Board of Directors Independence	0,0449	2,2145	0,0269	Significant Positive
Board of Directors Meetings	0,0324	2,5879	0,0102	Significant Positive
Board of Directors Expertise	0,0224	0,4104	0,6818	Not significant
Audit Committee Size	0,0838	1,0920	0,2759	Not significant
Audit Committee Independence	0,0228	2,0530	0,0420	Significant Positive
Audit Committee Meeting	0,0188	1,9709	0,0499	Significant Positive
Audit Committee Expertise	0,0218	0,0405	0,0377	Significant Positive

Source: Processed Secondary Data (2023)

The following are the results of hypothesis testing:
Earnings management is significantly impacted by five elements. Earnings management is greatly benefited by the independence of the board of directors, board meetings, expertise of the audit committee, and independence of the audit committee. While Board Size, Board Expertise, Audit Committee Size have no significant impact on earnings management. This indicates that although the government has issued guidelines for the use of boards of directors and audit committees in business through the OJK, the effectiveness of these entities has not been a major determining factor in identifying earnings management practices in companies. For instance, the size of the audit committee and other characteristics of the board of directors have little bearing on the board's capacity to identify earnings management. This is proven (Rinta, 2021) states that managers who try to maximize the company's utility, so that the number of boards of directors in the company does not affect the company's earnings management.

Based on the variable, the independence board of directors has a probability value of 0.0629 < 0.05, so Hypothesis 2 is accepted, meaning that the independence board of directors has an influence on earnings management. Riyadh et al (2019)shows a substantial beneficial impact of an independent board of directors on earnings management. An independent board of directors has the authority to restrict the company's profits management strategies in accordance with the management principle of agency theory. Overseeing management and ensuring that the goals managers pursue are in line with the interests of shareholders is a crucial role of an independent board of directors.

Based on the variables of board of directors meetings and audit committee meetings, the probability value is smaller than α = 0.05, so Hypothesis3 and Hypothesis7 are accepted, meaning that board of directors meetings have a positive effect on earnings management. The board of directors is responsible for supervising internal control and the financial reporting process, according to the findings of (Alzeban & Sawan, 2015). Consequently, lower earnings management will be the more frequently the audit committee and board of directors meet. The results of the study (Tai et al., 2020) also show that audit committee meetings have a positive effect on reducing earnings management, meaning that audit committees that actively hold meetings can be considered well structured so that they are able to carry out their duties and functions to minimize earnings management. Meetings allow audit committee members to discuss issues that are their responsibility in overseeing the company.

Model Fit Test

Table 9. Model goodness of fit test results Model fit test results

Dependent variable	*Adjusted R-Squared*
Earnings Management	*0,690418*

Source: Processed Secondary Data (2023

Table 5's result, 0.690418, indicates that 69.04% of the explanation for earnings management may be attributed to the study's independent factors. While factors not included in the research variables account for 30.96% of the remaining explanation.

CONCLUSION

A large number of board members is not a guarantee that earnings management will be reduced, according to the results and discussion. Board size is determined to have no discernible positive influence on earnings management. Earnings management is much enhanced by the independent board of directors. Additionally, board meetings help with earnings management. The board of directors' level of experience has no bearing on managing earnings. The amount of members on an audit committee does not necessarily translate into less earnings management, as the size of the committee has a negligible positive impact on earnings management. The independent audit committee, in accordance with agency theory, performs its role in overseeing the behavior of managers as managers. The audit committee has a very beneficial impact on managing earnings. Earnings management is also impacted by the audit committee's level of expertise.

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