Earnings Management and Corporate Governance Performance: The Case of Building Construction Company

Meita Sekar Sari[1*], Tubagus Ismail[2], Muhammad Taqi[3], Rudi Zulfikar[4]
{meita_sekar@yahoo.co.id[1]*}

Faculty of Business, University of Sultan AgengTirtayasa[1234]
Faculty of Business, University of Mitra Indonesia[1]

Abstract. A company's main principle is its earnings reports.The aim of this research is to examine the consequences of a well-run company, represented by the Board of directors, audit committee and managerial ownership on financial performance and to analyze earnings management on earnings report. The Board of directors, audit committee, managerial ownership, and earnings management as independent variables, whereas financial performance with ROA as dependent variable.Secondary sources management was applied in this research. The total population used in this research were 17 building construction sub-sector companies, which are listed on the Indonesia Stock Exchange. This survey's method of collecting data was purposive sampling and obtained data from 8 companies. The Board of directors isas defined by the number of associates, the audit committee is measured by the number of members, management ownership is measured by the percentage between the number of owned shares and the total outstanding shares, earnings management is measured by Discretionary Accruals Net Profit - Cash and Cash Equivalents/Total Assets t-1) and financial performance using ROA (Return On Assets).The evaluation method employs the classical assumption test, several linear regression testing, the ρ of determination test, and testing of hypotheses.Based on the findings, it is possible to conclude that the Board of Directors, audit committee, managerial ownership, and earnings management all have a considerable impact on ROA. ROA is influenced in part by the management board, audit committee, managerial ownership, and earnings quality.

Keywords: Good Corporate Governance, The Board of Director, Audit Committee, Managerial Ownership, Earnings Management, ROA.

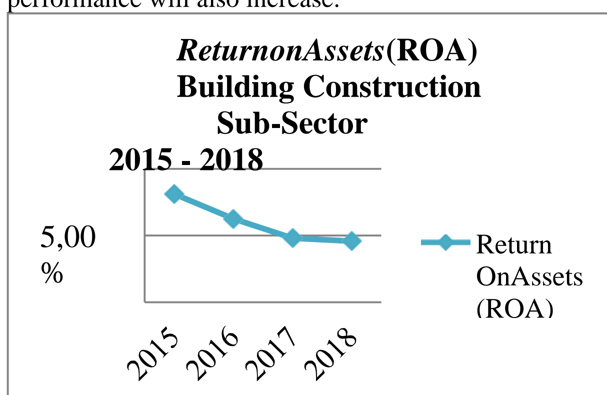
1. Introduction

Today, companies need to improve performance and innovation in business competition. In general,both financial and non-financial data can be employed to assess corporate performance. Corporate governance's greatly affect as measured by size of a board of directors (UKD), board of directors meeting (RAD) and board compensation (KOD) on financial performance and several investigations have been carried out to ascertain the worth of businesses.The management function is performed out by the board of directors in Indonesia, which has a multiple mechanism, and the managerial function is conducted out by the commissioner. The company's performance will enhance if corporate governance is carried out directly by the directors and the position of authority or the procedure for boarding is carried out smoothly by the representatives. [1]

A set of procedures governs financial reforms and mechanisms that have been accomplished in a company, which functions to reduceexecutives on the board of trustees,

ICOSTELM 2022, November 04-05, Bandar Lampung, Indonesia
Copyright © 2023 EAI
DOI 10.4108/eai.4-11-2022.2328764

control performance and company value. Therefore, the greater the system's efficiency in a company, the better the employee's performance. [2] Financial performance is determined by the company to implement financial governance. [3] Financial performance is the main benchmark for company performance. This is obtained from the annual financial report. The measurement of business financial performance can be viewed from two sides, internal and external factors. It is calculated from each business value with business performance. The most frequently used indicator is Return on Assets (ROA). Return on Assets (ROA) shows the effective assets used togenerate revenue. Thus, the higher the return on assets, the company's performance will also increase.



The line graph depicts the asset return on assets (ROA)in 2015 was 8.12% and decreased in 2016 to 26.6%. Furthermore, there was a decline of 4.81% and 4.58% in 2017 and 2018. Return on Assets Data (ROA) decreased from 2015 to 2018 which means financial performance has decreased. This is caused by poor implementation of earnings control and management mechanisms.

The implementation of Corporate Governance secures the equity holders' preferences and public. The board of directors supervises and directs company's role in enhancing thethe business's performance.As a consequence of the business's separation of ownership and management, the investigation from agency cost theory provides an understanding of the necessity of observing the conduct of managers. [4] In addition,the implementation of the GCG control mechanism and the profit rate are the factors that determine the financial company performanceduring a particular period of time. Based on the profits generated, a business company can distribute dividends to shareholders and increase the development of company business while maintaining the viability of a business.

The Corporate Governance in large companies has a tendency to carry out earnings management by minimizing profits, while small companies have a tendency to report larger profits to show better company performance.[5]Even though financial institutions such as banks are tasked with maintaining financial prosperity, earning management practices have proven to be a potentially risky factor in the financial industry than in any other industry. If financial institution managers do not fulfill their responsibilities honestly and conceal extremist speculative information, they potentially create a burst that breaks and crumbles the entire economy [6]. Intervention of accounting records by company officials, on the other hand, is not considered duplicitous as long as financial reporting methods and practices are widely accepted. Many financial reporting rules and principles necessitate an assessment from company management [7].

The rapidly growing manufacturing company has an impact on business competition,especially in the building construction sub-sector which tends to develop very quickly in modern era. The earnings management tends to be more researched by financial institutions than manufacturing companies [7]. The increasing percentage of market expansion will decrease the amount of earnings paid to shareholders. As a result, the majority of the company's value are used to fund the economic growth. It is reasonable to conclude that the residual profit distributed as dividends is shrinking. The future expansion of the company's assets will necessitate significant funds. Instead of paying dividends to shareholders, the managers prefer to maintain profits in internal funds and engage the others in profitable projects. [8]

2. Literature Review

2.1 Agency Theory

The agency theory attempts to create a suitable framework. Common stockholders are founders in a corporation, and management teams are agents who collaborate in the public's interest. Another well industry for corporate control is considered to be absent in agency theory, resulting in market distortion, market absence, malinvestment, market imperfections, inadequate agreements, and default risk. [9]

2.2 Good Corporate Governance

The effective use of CG is not only used to increase managerial efficiency but also maximize shareholder earnings by prohibiting management from engaging in fraudulent acts. Most practitioners conclude that investors in the equity market provide higher value to companies with a better regulated system [6]. Based on the above definition, GCG is a process that regulates and controls a business for the benefit of stakeholders.

GCG has gained recognition over the past ten years. To begin, GCG is among the access codes to a company's capacity to expand, policy aims to increase profits, and dominate business worldwide. Second, the failure to implement GCG may lead to economic disasters in Asia and Latin America. [10]

2.3 The Board of Directors

The stockholder has the authority and accountability for outcome as a functional mechanism, and the board of directors must accomplish the commitment to direct the company's future. [11]

The internal parties are responsible for running the company's management operations. The committee of directors' delegates are appointed by the GMS or the general assembly. The board of trustees is completely liable for the company's operations and management in order to defend the company's interests and objectives.According to Fithriyah Lailatul (2018), the board of directors is calculated by the following formula:

Board of Directors = Total Members of the Board of Directors

2.4 Managerial Ownership

An supervisory board is one of a corporation's board of directors' major functional

committee members in responsible for supervising economic accounting and disclosure.The board of directors and committees must identify opportunities for the company to develop, as well as consider the risks that affect the company's performance [12]. Assessment of the Audit Committee using the following formula:

$$\text{Audit Committee} = \text{Total Audit Committee}$$

The connection among institutional ownership, audit committee independence, and performance outcomes is defined in opposite paths concurrently and causally. Financial performance suffers as a result of managerial ownership, and likewise.The assumption of a negative relation exists between independent directors and corporation and company performance and/or conversely was discovered to be accurate, suggesting a negotiated settlement with legitimacy theory [11]. Property management exists as a result of agency theory. The correlation between managers and shareholders, according to agency theory, is comparable to the correlation between agents and stockholders.The managerial ownership can be calculated based on the formula:

$$\text{Managerial ownership} = \frac{\text{Total of shares owned by management}}{\text{Total outstanding shares}} \times 100$$

2.5 Earnings Management

The earnings management has long-lasting implicationsimplications for company value, because of its fundamental role in determining company profits and the future value of companies that have been studied in the corporate finance literature [13]. Many accounting rules and principles require company management to provide an assessment [7]. Earnings management in this research is a managerial activity carried out to increase a person's income or increase financial performance

2.6 Financial Performance

Financial results demonstrates how effectively and quickly a corporation achieves its objectives. The capacity of supervisors to determine suitable instruments to achieve particular targets is referred to as effectiveness. The ratio of input to output is referred to as efficiency. The optimal output will result from the appropriate input. Improving revenue growth is a prerequisite for attracting investors. The documented financial report is a portrayal of a company's financial performance. The final outcome of the accounting process is profitability ratios, which provide information about financial circumstances. Reports are used by investors and managers to make investment decisions. The implications of financial statements is determined by who necessitates the reports and how frequently they are required [10].

3. Research Methods

The information utilized in this research is secondary. The total sample for this research was 17 construction process comment thread companies that are mentioned on the Indonesia Stock Exchange from 2014 to 2021.The data collection technique in this research was purposive sampling and obtained data from 8 companies.

4. Results and Discussion

Table 1. Coefficient of Determination R2

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.969[a]	.938	.933	.96757

a. Predictors: (Constant), ML, DD, KM, KA

b. Dependent Variable: ROA

Table 2. F Test

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	613.734	4	153.433	163.892	.000[b]
	Residual	40.256	43	.936		
	Total	653.990	47			

a. Dependent Variable: ROA

b. Predictors: (Constant), ML, DD, KM, KA

Table 3. T test

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-5.059	1.248		-4.052	.000
	DD	.779	.201	.255	3.880	.000
	KA	1.544	.354	.359	4.355	.000
	KM	.033	.008	.326	4.263	.000
	ML	.069	.025	.152	2.739	.009

a. Dependent Variable: ROA

4.1 The Financial Performance Impact of Good Corporate Governance and Earnings Management

According to the observations of hypotheses,the corporate governance and earnings management have a simultaneous effect on financial performance and produce an F value of 163,892 and an F table of 2,565. Then F count > F table with Sig. 0.000. This shows that the result is smaller than 0.05. The Adjusted R2 coefficient of determination is 0.933 or 93.3% in

table 1. This means that the effect of GCG and earnings management on financial performance is 93.3%, while 6.7% is another indicator.

The Company that implements Good Corporate Governance has optimal management and financial performance. The Company has indeed established Good Corporate Governance fundamentals such as clarity, accountability, equality, and obligation.In addition, the company's financial performance will increase if it implements earnings management. This is consistent with the legitimacy theory, which maintains that the company must be accountable to the society that it directly effects because its determinations and behavior impact the community's general well-being.If the relationship between the community and the company runs smoothly, it will create life sustainability for both parties. Some examples areclients who are committed to the company and employees who perform efficiently. This will improve the company's financial performance. [3]

4.2 The Effect of the Board of Directors (X1) on Financial Performance (Y)

The partial test analysis (T) of the Board of Directors on the partial financial performance is sig. 0.000 and T 3,880. The value of T table with four independent variables was obtained with N = 48 and T table .01669. Statistically, the significance is < 0.05 and T count > T table, which means the board of directors has a partial and significant effect on the company's financial performance.This demonstrates the significance of the board of directors in the company. This can improve business performance and have an impact on improving business financial performance.

The findings of this research also encourage the knowledge theory, which indicates that gender equality enhances profitability. Furthermore, corporate governance such as board size, abroad directors, as well as board expertise have no significant impact on the company's profitability. The inconsequential connection can be attributed to a lack of self government and competence [14].

4.3 The Effect of the Audit Committee (X2) on Financial Performance (Y)

The partial test analysis of partial financial performance resulted in aT 4.355 and a significance level of 0.000. The value of T table with four independent variables with N = 48 and the value of T table is 2.01669. Statistically the significance value is more than 0.05 andthe t - statistic value exceeds the T table, which means that this research confirms the audit committee has a partial and significant influenceon a company's financial standing. The audit committee is expected to produce financial statements that are relevant and cannot be changed by either party. It can be used as a management review. The audit committee is also expected to create a transparent business environment to improve company performance.

The board of directors establishes an audit committee to oversee the transparency of the company's accounts. In addition, to inform shareholders and other stakeholders about the level of risk in the company. Because of its unique role in protecting equity holders' interests in financial and supervision, the audit committee is the most essential subcommittee of the board [12].

4.4 The Effect of Managerial Ownership (X3) on Financial Performance (Y)

The partial test analysis on partial financial performance is a significance value of 0.000 and a T value of 4.263. T table value with four independent variables with N = 48 and T table 2.01669. Statistically, the significance is < 0.05 and the estimated T > table T. This research shows thatmanagement equity has a minor but significant affect on a company's overall financial performance..Low managerial ownership can eliminate corporate governance risks, increase

company value, and develop employee motivation by offering compensation plans [15].

4.5 The Effect of Earnings Management (X4) on Financial Performance (Y)

The partial test analysis on partial financial performance is a significance value of 0.009 and a T value of 2.739. The value of T table with four independent variables with N = 48 and the T table value is 2.01669. Statistically the significance is < 0.05 and T count > table T. This reserach shows that earnings management has a partial and significant effect on the company's financial performance. Based on some previous research, the earnings management is an act of fraud and non-fraud. This is due to the different accounting and company laws in each country. Therefore, it can be classified as earnings management in one country but as earnings fraud in another. Revenue fraud is a violation of accounting standards and company laws, with laws adjusted by each country. This problem can be solved if countries have the same accounting and reporting standards [16].

5. Conclusions

Earnings management and Good Corporate Governance (GCG) have a major impact on financial performance. The Board of Directors has a substantial effect on the financial performance. The audit committee has a huge impact on financial performance. Management ownership has a significant bearing on financial performance.. Earnings management has a massive financial performance impact. In further research, in order to conduct a broader research with other objects. The research is expected to be used for all companies The Indicators of this research can use other indicators such as: Institutional Ownership and Board ofCommissioners. Suggestions for further research, in order to determine the factors that affect financialperformance to be more improved. The researcher recommends to use other financial performance indicators such as ROE, NPM and CPA. The observation period can be more than six years and adjust to the times.

References

[1] I. W. Widnyana, I. G. B. Wiksuana, L. G. S. Artini, and I. B. P. Sedana, “Influence of financial architecture, intangible assets on financial performance and corporate value in the Indonesian capital market,” *Int. J. Product. Perform. Manag.*, no. 1999, 2020, doi: 10.1108/IJPPM-06-2019-0307.

[2] M. Oana Pintea, A. M. Pop, M. Dan Gavriletea, and I. C. Sechel, “Corporate governance and financial performance: evidence from Romania,” *J. Econ. Stud.*, 2020, doi: 10.1108/JES-07-2020-0319.

[3] M. Mahrani and N. Soewarno, “The effect of good corporate governance mechanism and corporate social responsibility on financial performance with earnings management as mediating variable,” vol. 3, no. 1, pp. 41–60, 2018, doi: 10.1108/AJAR-06-2018-0008.

[4] R. Zulfikar, N. Lukviarman, D. Suhardjanto, T. Ismail, K. D. Astuti, and M. Meutia, “Corporate governance compliance in banking industry: The role of the board,” *J. Open Innov. Technol. Mark. Complex.*, vol. 6, no. 4, pp. 1–18, 2020, doi: 10.3390/joitmc6040137.

[5] V. Grougiou, S. Leventis, E. Dedoulis, and S. Owusu-Ansah, “Corporate social responsibility and earnings management in U.S. banks,” *Account. Forum*, vol. 38, no. 3, pp. 155–169, 2014, doi: 10.1016/j.accfor.2014.05.003.

[6] A. Asghar, S. Sajjad, A. Shahzad, and B. T. Matemilola, “Role of discretionary earning management in corporate governance-value and corporate governance-risk relationships,” *Corp. Gov.*, vol. 20, no. 4, pp. 561–581, 2020, doi: 10.1108/CG-11-2019-0347.

[7] R. Zulfikar *et al.*, "Antecedents of Disclosure on Internal Control and Earnings Management," *J. Asian Financ. Econ. Bus.*, vol. 8, no. 3, pp. 391–397, 2021, doi: 10.13106/jafeb.2021.vol8.no3.0391.

[8] E. Wahjudi, "Factors affecting dividend policy in manufacturing companies in Indonesia Stock Exchange," *J. Manag. Dev.*, vol. 39, no. 1, pp. 4–17, 2020, doi: 10.1108/JMD-07-2018-0211.

[9] L. Bonazzi and S. M. N. Islam, "Agency theory and corporate governance: A study of the effectiveness of board in their monitoring of the CEO," *J. Model. Manag.*, vol. 2, no. 1, pp. 7–23, 2007, doi: 10.1108/17465660710733022.

[10] Suhadak, Kurniaty, S. R. Handayani, and S. M. Rahayu, "Stock return and financial performance as moderation variable in influence of good corporate governance towards corporate value," *Asian J. Account. Res.*, vol. 4, no. 1, pp. 18–34, 2019, doi: 10.1108/AJAR-07-2018-0021.

[11] Y. G. Shan, "Managerial ownership, board independence and firm performance," *Account. Res. J.*, vol. 32, no. 2, pp. 203–220, 2019, doi: 10.1108/ARJ-09-2017-0149.

[12] S. R. M. Musallam, "E ff ects of board characteristics , audit committee and risk management on corporate performance : evidence from Palestinian listed companies," 2017, doi: 10.1108/IMEFM-12-2017-0347.

[13] M. S. Sial, Z. Chunmei, T. Khan, and V. K. Nguyen, "Corporate social responsibility, firm performance and the moderating effect of earnings management in Chinese firms," *Asia-Pacific J. Bus. Adm.*, vol. 10, no. 2–3, pp. 184–199, 2018, doi: 10.1108/APJBA-03-2018-0051.

[14] M. P. Assenga, D. Aly, and K. Hussainey, "The impact of board characteristics on the fi nancial performance of Tanzanian fi rms," 2018, doi: 10.1108/CG-09-2016-0174.

[15] K. Bhatti, M. I. U. Husnain, A. Saeed, I. Naz, and S. D. Hashmi, "Are top executives important for earning management and firm risk? Empirical evidence from selected Chinese firms," *Int. J. Emerg. Mark.*, 2021, doi: 10.1108/IJOEM-09-2019-0734.

[16] S. Baskaran, N. Nedunselian, C. H. Ng, N. Mahadi, and S. Z. Abdul Rasid, "Earnings management: a strategic adaptation or deliberate manipulation?," *J. Financ. Crime*, vol. 27, no. 2, pp. 369–386, 2020, doi: 10.1108/JFC-07-2019-0098.