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Implementation of Corporate Governance Influence to Earnings Management

Hedwigis Esti Riwayati[a]*, Markonah[b], Muljanto Siladjaja[c]

[a,b,c] *Perbanas Institute, Jakarta, 12940, Indonesia*

Abstract

The purpose of this paper is to test the influences of corporate governance implementation to earnings management practical. This research used two stages data analysis. Firstly, this research used asymmetrical information variable as intervening variable. Secondly it would have increased significant rate in Structural Equation Modeling those variable used without intervening variable. This research used primary data, collected by 70 respondents. The respondent are all experts, manager, decision maker and the owner. They are performers in the corporate governance. The research has the previous model and method which explain implementation of corporate governance reduced the bad impact of earnings management.

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Keywords: Corporate Governance; Asymmetrical Information; Earnings Management.

1. Introduction

Implementing corporate governance is considered suitable to repair bad images on banks, to protect the interests of stakeholders and to improve compliance toward legislation and general ethics of banking industry to portray a healthy banking system. Moreover, implementing good corporate governance is expected to affect banks performance, for applying corporate governance can improve financial performance, reduce risks of parties who are only zeroed in their own interests (Sari, 2010).

* Corresponding author. Tel.: + 6282113377150
E-mail address: hedwigis.esti@perbanas.id

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The issue of corporate governance is motivated by agency theory which states that the agency problems arise when managing a company apart from its holdings. The owner as a supplier of capital companies delegates authority to manage the company to professional managers. As a result, the authority to use company resources is in the hands of the executive. It raises possibility of moral hazard where management does not act in the best interests of the owner (conflict of interest). Managers with information, they may act only to benefit themselves at the expense of the owner for the manager has information about the company that is not owned by the owner (information asymmetry). This will affect the company's performance and eliminate investors' confidence in return on investments that they have planted in the company. To achieve good corporate governance, it requires a systematic mechanism to monitor all policies (Sari, 2010).

Research on the effect of corporate governance toward company's financial performance has been done by previous researchers. Wati (2012) conducted a study that aims to determine the effect of corporate governance implementation of financial performance in companies listed on the Indonesia Stock Exchange. Research results provide conclusion that the practice of Corporate Governance Perception Index (CGPI) significantly influence the company's financial performance as measured by return on equity and net profit margin. In contrast, Meythi and Devita (2011), the research results show that the variable corporate governance implementation does not affect the return on equity.

Referring to the results of empirical research that has been done, it appears that the empirical evidence shows the importance of implementing corporate governance to achieve corporate goals. This research was conducted to determine the effect of applying good corporate governance towards earnings management.

2. Theoritical review

2.1 Corporate Governance

The perspective of agency theory is used to understand the basic corporate governance. Agency theory is a concept that describes the contractual relationship between the principal (owner) and the agent (manager). The agency relationship manager is the party who has information about the company more than the owner, so that the resulting asymmetry of information is a state where there are parties that have more information than outsiders that benefit them (Deegan 2004 in Arifani, 2013).

According to Bukhori (2012), corporate governance has some principles that can be applied to every aspect of the business and the entire company. Principles of corporate governance according (Bukhori, 2012; Dharma, Christina, and Paskah, 2013) include the following: 1) transparency, companies should take the initiative to reveal not only the problems signaled by the legislation, but also important matters for decision-making by shareholders, creditors, and interests of the other parties; 2) accountability, is a necessary precondition to achieve continuous performance; 3) responsibility, the company has a responsibility towards society and the environment and must abide by the laws and regulations applicable to its business continuity so it can be maintained in the long term; 4) independence; and 5) equality and fairness, the company must always consider the interests of all stakehonders based on the principle of equal treatment and the principle of reasonable benefits.

2.2 Earnings Management

Earnings management assigned as the use of managerial judgment in structuring transactions to alter financial reports either to misinform stakeholders with respect to the firm's performance or to reap the benefit of a contractual outcome that is dependent on accounting numbers (Healy & Wahlen, 1999; Latif & Abdullah, 2015). Thus, managers can estimate future economic events at their discretion and these are reflected in firms' financial reports. Those events can include salvage value and the expected life of long-term assets, deferred taxes, asset impairment, losses from bad debts, and post-employment benefits (Healy & Wahlen, 1999; Latif & Abdullah, 2015).

Managerial discretion also have impact the choice of acceptable accounting methods for inventory costing, such as last-in-first-out (LIFO), first-in-first-out (FIFO), and average cost. These can have a significant impact on accounting outcomes in different economic conditions (Zhang, Shi, Gao, & Wang, 2014; Omar, Rashidah, Bello, & Saliza, 2014) and on recording transactions LIFO-FIFO is accelerated depreciation or the straight-line method. Waweru and Riro