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The Effect of Good Corporate Governance, Debt Contracts, and Intellectual Capital on Earnings Management

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ABSTRACT : The behavior of investors who tend to pay attention only to information about company profits without paying attention to the background of the earnings has created opportunities for company management to practice earnings management. This earnings management practice can be strengthened or minimized by various factors so that the purpose of this study is to obtain empirical evidence of the influence of good corporate governance, debt contracts, and intellectual capital. This research was conducted in non-financial state-owned companies listed on the IDX with a sample of 15 companies using purposive sampling method. Data collection was carried out by non-participant observation methods and using multiple linear analysis techniques. Based on the analysis, it is found that good corporate governance has a negative effect on earnings management, debt contracts have a positive effect on earnings management, and intellectual capital has a positive effect on earnings management.

Keywords: *good corporate governance, debt contracts, intellectual capital, earnings management*

I. INTRODUCTION

Statement of Financial Accounting (SFAC) No.1 regarding the purpose of financial reporting explains that financial reports provide financial information related to the company's economic activities and resources to investors and creditors as a matter of consideration for decision making in their capacity as capital providers. The income statement can be used as a reference for the success or failure of the company's performance in running its business. Earnings information can help interested parties estimate future earnings power (Arthawan and Wirasedana, 2018).

Investors tend to only pay attention to information about company profits without paying attention to the background of the earnings (Prabaningrat and Widanaputra, 2015). Positive accounting theory reveals that managers can choose an accounting method according to their choice so that managers can process earnings by increasing or decreasing profits to modify the company's financial statements (Watts and Zimmerman, 1986). The investor's behavior and the manager's actions have created opportunities to practice earnings management. Earnings management is the desire or ability of company management to change and engineer various accounting policies that are available with the aim of being able to achieve the level of profit expected by the company (Sari, 2019). Earnings management always occurs when management uses their judgment to present reports by tricking interested parties about the financial condition of a company to influence contractual results that depend on reported accounting figures (Belkaoui, 2007).

The phenomenon of earnings management practices has occurred several times in Indonesia, one of which is the case of financial reporting by the management of PT Garuda Indonesia (Persero) Tbk, a state-owned company (BUMN) engaged in the air transportation sector. This financial scandal occurred when Garuda Indonesia recorded a profit of around 11 billion rupiah in its 2018 financial statements, but in 2017 the airline suffered a deep loss of up to 3 trillion rupiah. Other cases occurred at PT Timah (Persero) Tbk in 2015, PT Indofarma (Persero) Tbk in 2001, and PT Kimia Farma (Persero) Tbk in 2001.

Cases regarding earnings management practices can arise because of an agency conflict between the principal (shareholders) and the agent (management) which results in management having the opportunity to report improper earnings. Agency conflicts occur between management who are obliged to meet the welfare of the shareholders as well as to fulfill the interests of personal welfare. The existence of salient differences in interests results in the emergence of information asymmetry. Raharjo (2007) states that there are two types of problems caused by information asymmetry, namely adverse selection and moral hazard. Adverse selection is a condition that results from an imbalance of information on the condition of the company, then moral hazard is a manager's action that can violate the work contract agreement and act opportunistically. Information asymmetry can provide an opportunity for management to practice earnings management because the agent knows more about the internal conditions and future prospects of the company than the principal, who only knows the condition of the company based on information from the agent.

Putri and Ulupui (2017: 4) explain that good corporate governance is a mechanism for managing a good company based on regulations, legislation and ethics in order to increase accountability to stakeholders and the added value of the company in the long term. The mechanism for implementing good corporate governance has four structures, namely institutional ownership, managerial ownership, independent commissioners and audit committee.

Institutional ownership is company shares owned by institutions or institutions such as insurance companies, investment companies and other institutional ownership. Institutional ownership is considered to reduce earnings manipulation because it can control management through an effective monitoring process that affects the preparation of financial statements (Saftiana, et al. 2017). Liu and Tsai's (2015) research results state that institutional ownership has a positive effect on earnings management, while the results of the research of Abdillah, et al. (2016) show that institutional ownership has a significant negative effect on earnings management. Managerial ownership is share ownership owned by management. This managerial ownership can influence management to act in accordance with the wishes of the principal and motivate management to improve its performance so that earnings management practices can be minimized. The research results of Abdillah, et al (2016) and Widyaningsih (2017) which state that managerial ownership has a significant effect on earnings management. The Independent Commissioner or the board of commissioners can influence management in preparing financial reports through their role in carrying out a supervisory function that has an impact on quality earnings. The results of research by Hendra et al. (2018) show that the composition of independent commissioners has a positive effect on earnings management. However, the research of Muda et al. (2018), independent commissioners have no significant effect on earnings management. The audit committee has the responsibility of supervising the financial statements of external audit results and monitoring the internal supervisory unit to prevent or minimize the opportunistic nature of management who practice earnings management (Budi, 2009) in Prabaningrat and Widanaputra (2015). Sari and Asyik's (2013) research results state that the audit committee has a positive effect on earnings management practices while the research by Muda et al. (2017) stated that the audit committee has no effect on earnings management.

Jensen and Meckling (1976) formulated that a company is seen as a nexus of contract, which means that the company is bound by several parties in the form of a contract. One of the contracts made to run the company is a debt contract as a source of funding. The debt contract made by the company is in the form of a debt agreement with the creditor. Companies that fulfill the debt agreement that has been made will certainly get a good performance appraisal, on the other hand, if the agreement is violated, financial penalties will be given which can harm the company.

Agency theory states that agents are usually opportunistic and do not like risk so that it is in line with the debt-covenant hypothesis, that companies that violate debt contract agreements tend to choose an accounting method that can move reported earnings, namely earnings management. This is done because an increase in net income can reduce the probability of a company's technical failure (Scott, 2015). The existence of a debt contract agreement gap measures the level of violation of the debt contract agreement, that is, the bigger the gap, the greater the company will violate the debt contract agreement (Kim et al., 2010).

Based on the resource-based theory, strategic resources are the root for obtaining the sustainability of a company's competitive advantage, one of which is an intangible asset in the form of intellectual capital. When economic conditions change to smart employee-based services, intellectual capital will become an asset that is of great concern to the company (Cardoza et al., 2006) in Setijawan (2011). Intellectual capital is one of the approaches used to measure and value a company's knowledge assets (Petty and Guthrie, 2000). Good intellectual capital management in the company shows that there is good management of assets as well (Pramanda and Husnah, 2014). Good asset management can improve company performance, which is reflected in company profits.

Research conducted by Prabaningrat and Widanaputra (2015) which states that good corporate governance proxied by independent commissioners has a statistically significant effect on earnings management which is in line with the research of Muda et al. (2018) which proxies that the independent commissioner and audit committee simultaneously have an effect on earnings management. However, the results of this study are not in line with the research conducted by Haryati and Cahyati (2015), which is proxied by independent commissioners and institutional ownership has no effect on earnings management and Laily's research (2017) which proxies that independent commissioners and audit committees have no effect on earnings management. As for research related to debt contracts in earnings management conducted by Arianti, et al. (2019) and Yupita, et al. (2017), it is stated that contracts have a significant positive effect on earnings management, however, research conducted by Venina and Nariman (2020) and Kim et al. al. (2010) states that debt contracts have a significant negative effect on earnings management, while the research of Gunawan et al. (2015) and Ramadhan (2017) states that debt contracts have no effect on earnings management. On the other hand, research on the relationship of intellectual capital to earnings management conducted by the results of research by Wato (2016) and Kalbuana et al (2020) states that intellectual capital has a positive effect on earnings management, while the research of Indra and Trisnawati (2020) states that intellectual capital has no effect. significantly on earnings management.

There is an inconsistency in the results of research on each of the previous variables which indicates the existence of a research gap and the existence of cases of earnings management practices by PT. Garuda Indonesia, Tbk in 2019 encourages researchers to conduct further research related to factors that influence management to practice earnings management by focusing on non-financial state-owned companies listed on the Indonesia Stock Exchange (IDX) because the phenomenon of earnings management practices is more common. in non-financial state-owned companies. In addition, non-financial state-owned companies have financial ratios that can be compared with each other as well as increasingly fierce competition due to the large number of non-financial companies, so the possibility to carry out earnings management activities is very large.

II. CONCEPTUAL MODEL AND HYPOTHESIS

Agency theory explains that earnings management problems can be minimized by monitoring through good corporate governance mechanisms. Good Corporate Governance provides opportunities for principals to supervise and influence agencies in opportunistic actions in company management. Good Corporate Governance can be used as the key to building a good corporate control and control system by ensuring management accountability for the principal based on regulations (Lubis et al., 2016).

The consistent implementation of good corporate governance can improve the quality of financial reports and reduce the occurrence of earnings management practices (Yogi and Eka, 2016). This means that the higher the level of implementation of good corporate governance in the company, the lower the opportunities for management to practice earnings management. The research results of Abdillah et al. (2016) state that good corporate governance, which is proxied by the audit committee, independent commissioners, and institutional ownership has a negative and significant effect on earnings management, which means that the higher the level of implementation of good corporate governance mechanisms, the lower the practice of corporate earnings management is in line. with research by Luthan, et al. (2016) which states that independent commissioners and audit committees have a negative and significant effect on earnings management, Anderson et al. (2004) found a negative and significant relationship between the audit committee and earnings management, and Bédard et al. (2004) found a negative and significant relationship between the audit committee and earnings management.

H_1: Good Corporate Governance has a negative effect on earnings management

The positive accounting theory developed by Watts and Zimmerman (1986) states that there is a desire to carry out earnings management as a result of the existence of a debt covenant called the debt covenant hypothesis. Creditors usually limit the payment of dividends, buy back outstanding shares, and increase debt to ensure payment of debt and interest (Watts and Zimmerman, 1986). The debt contract hypothesis states that companies with high debt tend to choose accounting methods and policies that can increase profits to avoid violating debt covenants. This is in accordance with agency theory which states that agents are usually opportunistic and Eisenhardst (1998) states that there is an assumption that humans are selfish, have bounded rationality, and do not like risk (risk averse) so that management companies tend to maximize their utility by processing company profits. The company will avoid various financial penalties such as accelerating the maturity of debt payments, increasing debt interest rates, and renegotiating the debt period (Arthawan and Wirasedana, 2018).

Earnings will usually be reported higher in order to maintain the company's reputation from external parties because if the company has a high debt ratio, it will experience additional funding difficulties from creditors and are threatened to violate the debt contract agreement (Sweeney, 1994). Kalay (1982) states that the higher the company's debt ratio, the more likely it is for company management to choose an accounting method that can increase profits. Astari and Suryanawa (2017); Arianti et al (2019); Agustia and Suryani (2018); and Nalarreason et al. (2019) states that debt contracts defined with leverage have a positive and significant effect on earnings management.

H_2: Debt contract has a positive effect on earnings management

Resource-based theory explains that the source of a company's sustainable competitive advantage is a resource that is valuable, scarce, inimitable, and there is no substitute for it (Barney, 1991). The approach that can be used to value intangible assets is intellectual capital which is an intangible asset (resources, capabilities and competencies) that can drive organizational performance (Bontis et al., 2000). Pulic (1998) states that the purpose of intellectual capital is to create additional value for the company (value added).

According to agency theory, management as an agent is given the authority to manage the company by principals or interested parties to work with the aim of improving company performance. In addition, agency theory also explains the assumption that humans are self-interested, have bounded rationality and dislike risk (Eisenhardst, 1989). On the basis of this human nature assumption, management tends to practice earnings management by utilizing and maximizing the competencies of the company. Management who has good competence is considered capable of working effectively and efficiently to manage company profits properly to achieve certain company performance and value. Research related to this, namely the research of Wato (2016) states that intellectual capital has a positive effect on earnings management. The results of research by Kalbuana et al (2019) state that intellectual capital has a positive and significant effect on earnings management. This means that the size of the use of intellectual capital in companies affects earnings management because intellectual capital contributes to improving company performance.

H_3: Intellectual capital has a positive effect on earnings management

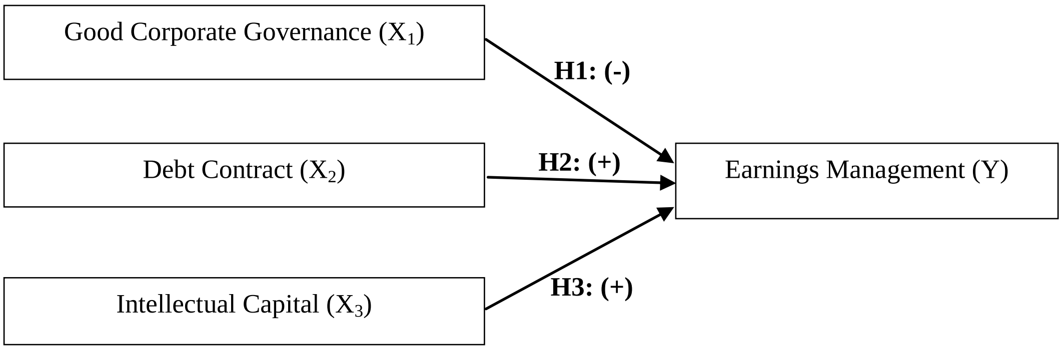

Figure 1. Conceptual Framework

III. RESEARCH METHODS

This research was conducted in a non-financial state-owned company listed on the Indonesia Stock Exchange (IDX) by accessing the website www.idx.co.id and the company website to obtain annual reports which were the research samples. The population of this study were all 16 state-owned non-financial companies listed on the Indonesia Stock Exchange for the 2017-2019 period. The sample of this study was taken using purposive sampling technique with a total sample of 15 non-financial state-owned companies listed on the IDX for the 2017-2019 period. The method in selecting the sample is a non-probability sampling method, namely purposive sampling technique. This study used non-participant observation data collection methods. The data analysis technique used is multiple linear regression analysis.

Table 1 List of Samples of Non-Financial State-Owned Companies Listed on the IDX

No.	Stock code	Company Name
1.	ADHI	Adhi Karya (Persero) Tbk.
2.	ANTM	Aneka Tambang Tbk.
3.	GIAA	Garuda Indonesia (Persero) Tbk.
4.	JSMR	Jasa Marga Tbk.
5.	KAEF	Kimia Farma Tbk.
6.	KRAS	Krakatau Steel (Persero) Tbk.
7.	PGAS	Perusahaan Gas Negara Tbk.
8.	PTBA	Bukit Asam Tbk.
9.	PTPP	PP (Persero) Tbk
10.	SMBR	Semen Baturaja (Persero) Tbk.
11.	SMGR	Semen Indonesia (Persero) Tbk.
12.	TINS	Timah Tbk.
13.	TLKM:	Telekomunikasi Indonesia (Persero) Tbk.
14.	WIA	Wijaya Karya (Persero) Tbk.
15.	WSKT	Waskita Karya (Persero) Tbk.

Source: Data processed, 2021

IV. RESULTS AND DISCUSSION

Multiple linear regression analysis is used to determine the effect of good corporate governance (X_1), debt contracts (X_2), and intellectual capital (X_3) on earnings management (Y). The results of the multiple linear regression analysis are presented in Table 2.

Table 2 Results of Multiple Linear Regression Analysis

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-0,002	0,006		-0,395	0,695
	Good Corporate Governance	-0,017	0,008	-0,260	-2,177	0,035
	Debt Contract	0,015	0,004	0,371	3,731	0,001
	Intellectual Capital	0,002	0,001	0,420	3,321	0,002
a. Dependent Variable: Earnings Management						

Source: Data processed, 2020

Based on the results of the regression analysis as presented in Table 2, the following structural equations can be made: $\hat{Y} = -0{,}002 - 0{,}017\ X_1 + 0{,}015\ X_2 + 0{,}002\ X_3$…………….……………....(1)

The Effect of Good Corporate Governance on Earnings Management

The first hypothesis (H_1) states that good corporate governance has a negative effect on earnings management. A significance value of 0.03 <0.05 indicates that H_1 is accepted. This result means that good corporate governance has a negative effect on earnings management or in other words the increasing implementation of good corporate governance will decrease earnings management practices, on the other hand, the decreasing implementation of good corporate governance, the increasing earnings management practices.

The results of this study are in line with agency theory and stewardship theory. Based on agency theory, agency relationships occur when the principal delegates management authority of the company to the agent. The existence of this agency relationship can cause problems in the form of information asymmetry due to differences in interests between principals and agents (Jensen and Meckling, 1976). The limitations of agency theory have led to the concept of good corporate governance. According to the philosophical assumptions of stewardship theory, humans are intrinsically trustworthy, responsible, and have integrity and honesty with other parties which have implications for good corporate governance (Putri and Ulupui, 2017: 24). Good Corporate Governance provides opportunities for principals to supervise and influence agencies in opportunistic actions in company management. Good Corporate Governance can be used as the key to developing a good corporate control and control system so as to reduce earnings management practices that can harm principals so that the higher the level of implementation of good corporate governance in the company, the lower the opportunities for management to practice earnings management.

The results of this study are in line with research conducted by Abdillah et al. (2016) proxied by the audit committee, independent commissioners, and institutional ownership, Luthan, et al. (2016) states that independent commissioners and audit committees have a negative and significant effect on earnings management. Anderson et al. (2004) found a negative and significant relationship between the audit committee and earnings management, and Bédard et al. (2004) found a negative and significant relationship between the audit committee and earnings management.

The Effect of Debt Contracts on Earnings Management

The second hypothesis (H_2) states that debt contracts have a positive effect on earnings management. Based on the results of multiple regression analysis of debt contracts on earnings management, it is obtained a significance value of 0.001 with a coefficient value of 0.015. A significance value of 0.001 < 0.05 indicates that H_2 is accepted. This result means that debt contracts have a positive effect on earnings management or in other words the increasing incidence of debt contracts will further increase earnings management, on the other hand, if debt contracts decrease, earnings management will decrease.

The results of this study support agency theory and positive accounting theory. Watts and Zimmerman (1986) state that the desire to manage earnings due to debt covenants is called the debt covenant hypothesis. This hypothesis states that companies with high debt ratios tend to choose accounting methods and policies that can increase profits to avoid violating debt covenants. In addition, agency theory also explains the assumption that human nature is selfish, has bounded rationality, and dislikes risk (risk averse). This can explain that when management gets closer to indications of violating debt covenants, the greater the management will practice earnings management to avoid the threat of default, namely not being able to fulfill obligations in debt contracts on time (Pramesti and Budiasih, 2017). The results of this study are in line with research conducted by Astari and Suryanawa (2017); Arianti et al (2019); Agustia and Suryani (2018); and Nalarreason et al. (2019) which states that debt contracts defined by leverage have a positive and significant effect on earnings management.

The Effect of Intellectual Capital on Earnings Management

The third hypothesis (H_3) states that intellectual capital has a positive effect on earnings management. Based on the results of the t test of intellectual capital on earnings management, a significance value of 0.002 is obtained with a positive coefficient value of 0.002. A significance value of $0.002 < 0.05$ indicates that H_3 is accepted. This result means that intellectual capital has a positive effect on earnings management, or in other words, the increase in intellectual capital will further improve earnings management, on the other hand, if intellectual capital decreases, earnings management will decrease.

The results of this study support agency theory and resource-based theory. Resourced-based theory explains that a company will achieve a competitive advantage if it has superior resources. These resources can be in the form of tangible and intangible resources. Intellectual capital is an intangible asset in the form of resources, capabilities, and competencies that can drive organizational performance (Bontis et al., 2000). Optimal utilization and management of intellectual capital results in improved financial performance. Human resources with good insight are considered capable of working effectively and efficiently to manage company profits properly which will affect the company's future performance. In accordance with the agency theory which explains the assumption of human nature that is selfish (self interest), has bounded rationality, and does not like risk (risk averse) so that management tends to take advantage of competence by processing company profits, namely conducting earnings management achieve certain profits as a reflection of the company's performance level. The results of this study are in line with the research conducted by Wato (2016) and Kalbuana, et al (2019) which states that intellectual capital has a significant effect on earnings management, which means that the amount of intellectual capital in companies affects earnings management because intellectual capital contributes to company performance.

V. CONCLUSION

Based on the results of research analysis and discussion results, the conclusion of this study is that good corporate governance has a negative effect on earnings management. This means that good corporate governance can be used as the key to developing a good corporate control and control system so that it can reduce earnings management practices that can harm principals so that the higher the level of good corporate governance in the company, the lower the opportunities for management to practice earnings management. Debt contracts have a positive effect on earnings management. This means that companies with high debt ratios tend to choose accounting methods and policies that can increase profits to avoid violations of debt covenants so that the higher the company's debt ratio, the more it will improve earnings management practices. Intellectual capital has a positive effect on earnings management. This means that the optimal utilization and management of intellectual capital, in this case well-informed human resources, are able to work effectively and efficiently to manage company profits well which will affect the company's performance in the future so that increasing intellectual capital will further improve management. profit, on the other hand, if intellectual capital decreases, earnings management will decrease.

Suggestions from this study for companies, especially non-financial state-owned companies, the results of this study can be used for information and input to management related to earnings management by maximizing the application of good corporate governance to realize good corporate management performance and minimizing debt ratios that can lead to debt contract violations. and not utilizing intellectual capital with opportunistic aims, so that the company does not need to carry out earnings management practices that are detrimental to the company's image in the eyes of the stakeholders. For future researchers who want to further investigate the effect of good corporate governance, debt contracts, and intellectual capital on earnings management, this can be done by expanding the scope of the research sample, extending the span of the observation year, and using moderating variables to further support the research results.

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