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## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

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**ABSTRACT:** This research aims to provide empirical evidence on the influence of corporate governance mechanism (audit committee, independence board of commissioner, institutional ownership, managerial ownership), accounting conservatism, and company size on earnings quality.

Sample used in this research are manufacturing company listed in Indonesia Stock Exchange (IDX) in 2016-2018 using purposive sampling and obtained 29 companies. This research used secondary data of annual report or financial statement obtained from Indonesia Stock Exchange (IDX) or company website in 2016-2018 period. Data were analyzed using multiple regression method.

The finding of this research are institutional ownership and managerial ownership partially has positive significant effect to earnings quality. The accounting conservatism and company size partially has negative significant effect to earnings quality. Whether the audit committee and independence board of commissioner has no significant effect to earnings quality. In addition, corporate governance mechanism, accounting conservatism and company size simultaneously has a significant effect to earnings quality.

**KEYWORDS:** Corporate Governance Mechanism, Accounting Conservatism, Company Size, Earnings Quality

### INTRODUCTION

Financial reporting, one of the main focuses is information on earnings, which provides information on the financial performance of a company over a period of time. Most investors will tend to see the quality of existing profits in a company as one of the biggest determinants of investment. Earnings information is very important because it affects the important decisions of users of the financial statements. Profits that do not provide true information on management performance may be misleading to users of the report. Corporate governance is a concept designed to improve management performance through monitoring in order to ensure accountability to shareholders. In addition to being able to reduce the Agency's conflict, corporate governance is also capable of creating added value for stakeholders in the form of effective protection, in particular for investors to recover their investments in a natural and high-value manner.

Various research results are available on the impact of corporate governance mechanisms on the quality of earnings. Dini Gunawan's research (2010-2014 period) showed that institutional ownership, independent board of commissioners and audit committee had a significant positive effect on the quality of earnings, while managerial ownership had no effect on the quality of earnings. Research by Rahmah Helmi (2010-2014) has shown that the audit committee and the independent board of commissioners have not significantly influenced the quality of earnings. The results of Putri Sudirman's research (2013-2015) showed that institutional ownership had a negative impact on the quality of earnings.

The principle of conservatism is one of the principles adopted in the financial reporting process. Conservatism is a careful response to existing uncertainties so that the uncertainties and risks associated with the business situation can be sufficiently considered. On the basis of the definition of conservatism, the practice of accounting conservatism often slows or slows down the recognition of income. This research is motivated by research conducted by Rahmah Helmi (2010-2014 period) which has shown that the quality of earnings is significantly influenced by accounting conservatism. Meanwhile, MiladitaSepniatiAisyah's research (20122014) found that accounting conservatism had no effect on the quality of earnings.

14

## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

While the size of the company can determine whether or not the company is performing. Investors usually have more confidence in large companies, as large companies are seen to be able to continue to improve the performance of their companies by trying to improve the quality of their profits. The size of the company is related to the quality of earnings, because the larger the size of the company, the continuity of the business of the company will be higher in improving financial performance, so that the company does not need to practice manipulation of earnings. The results of the study by SilviyaYenniMarsela et.al. (2013-2016) states that the size of the company has a positive effect on the quality of earnings. Meanwhile, the results of RedyArisonda's research (20152017) indicated that the size of the company had a negative impact on the quality of earnings.

Referring to some of the previous studies, there are several different levels of relevance to the results of the study and the still limited number of studies conducted in Indonesia. On the basis of this background, the researchers are interested in conducting research "THE INFLUENCE OF CORPORATE GOVERNANCE MECHANISM, ACCOUNTING CONSERVATISM, AND COMPANY SIZE ON EARNINGS QUALITY."

### 10 LITERATURE REVIEW

#### Agency Theory

The agency theory is a theory that describes the relationship between owners and agents or agencies in the management of companies. In managing a company, the owner, the shareholder, tends to appoint an agent (management) to carry out the operations of the company. Shareholders tend to want their company to keep going (going concern) and to get the maximum return on the investments made, while management wants high rewards for the company's performance. Management, as a company manager, has more information about the company than the shareholders so that there is information asymmetry. Management is often used to conduct profit-oriented accounting practices to achieve certain performance (Helina and Meiryandana Permanasari:2017).

#### Earnings Quality

Earnings quality is one of the information affecting stakeholders in making decisions about the company concerned (Noor Yudawan:2016). Earnings quality in this study is measured using the quality of income ratio as used by Noor Yudawan (2016) and Muhammad Rizki (2015). A ratio of greater than 1.0 usually indicates high-quality income, while a ratio of less than 1.0 indicates low-quality income. So the Earnings Quality can be calculated using the following formula:

$$EQ = \frac{\text{Operating Cash Flow}}{\text{Net Income}}$$

2

#### Corporate Governance Mechanism

According to Boediono (2005), the view of agency theory is that there is a separation between the agent and the principal. This may result in the appearance of a potential conflict affecting the quality of the reported earnings. Management with particular interest earnings will tend to prepare a report in accordance with the purpose and not in the interests of the principal. In such circumstances, a control mechanism is needed to align the interests of the difference between the two sides. The Corporate Governance Mechanism has the capability to generate a financial report containing an information return.

6

#### Audit Committee

An audit committee is a committee formed by the company's board of commissioners, whose members are appointed and dismissed by the board of commissioners and members consist of at least three members, whose task is to assist in carrying out checks or research deemed necessary for the implementation of the directors functions in the management of the company (Effendi:2009). According to (Septiana, Hidayat, and Sulasmiyati, 2016:4) stated that the audit committee can be measured based on the number of audit committees the company has. So the formula for calculating the audit committee is as follows:

$$AC = \sum \text{Audit Committee}$$

#### Independence Board of Commissioner

An independence commissioner is a body within a company that usually consists of an independent board of commissioners from outside the company whose function is to assess the overall and overall performance of the company Herawaty (2007). Variable Independent Commissioner Siallagan&Machfoedz (2006) measured by:

$$IC = \frac{\text{Number of Independence Commissioners}}{\text{Total Number of Commissioners}} \times 100\%$$

## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

### Institutional Ownership

Institutional ownership is the percentage of shares owned by institutional investors. Companies that have a composition institutional ownership in large numbers (more than 5%) better ability to oversee management (Cai et.al, in Putri, Rasmini, & Mimba, 2017:8). Institutional ownership is measured by the number of shares. According to (Manurung and Wibisono, 2015:7) stated that Institutional ownership can be measured by dividing the amount Institutional shares with total outstanding shares are then multiplied by 100%. So the formula for calculating institutional ownership is as follows:

$$IO = \frac{\text{Number of Shares owned by Institution}}{\text{Total Outstanding Shares}} \times 100\%$$

### Managerial Ownership

The quality of the reported earnings may be affected by management ownership. As a result of pressure from capital markets, companies with low management ownership will choose the method of accounting for the reported increase in earnings and will not reflect the actual economic situation of the company (Boediono:2005). Managerial ownership in Boediono's research (2005) is measured by:

$$MO = \frac{\text{Number of Shares owned by Management}}{\text{Total Outstanding Shares}} \times 100\%$$

### Accounting Conservatism

Accounting conservatism measured through the accrual basis of Givoly and Hayn model (2002) states that if accrual is negative, then the earnings is classified as conservative, which is caused by lower earnings than cash flows obtained by the company in a given period, namely:

$$CON\_ACC = \frac{\text{Net income} + \text{Depreciation} - \text{Operating Cash Flow}}{\text{Total Asset}} \times -1$$

### Company Size

Company size is the size of a company that can be classified based on various ways, including the size of revenue, total assets, and total equity (Brigham and Houston:2009). Company size is measured by natural logarithm (Ln) of the total assets owned by a company. The measurement used is a ratio scale (Rachmawati and Triatmoko:2007), namely:

$$\text{Size} = \text{Ln}(\text{Total Assets})$$

### Research Framework

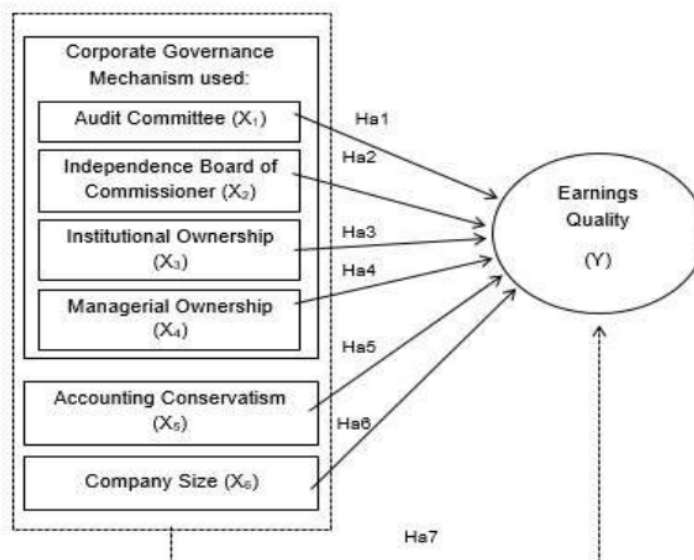


Figure 1. Research Framework

14

## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

3

Based on the above explanations, the hypotheses of this research are as follows:

- Ha1 : There is an influence of the audit committee on earnings quality.
- Ha2 : There is an influence of the proportion of independence Board of Commissioner on earnings quality.
- Ha3 : There is an influence of the institutional ownership on earnings quality.
- Ha4 : There is an influence of the managerial ownership on earnings quality.
- Ha5 : There is an influence of the accounting conservatism on earnings quality.
- Ha6 : There is an influence of the company size on earnings quality.
- Ha7 : There is the influence of Corporate Governance Mechanism, Accounting Conservatism, and Company Size on Earnings Quality.

### RESEARCH METHODOLOGY

#### Population and Sample

The population used in this study are nonfinancial companies listed on the Indonesia Stock Exchange (IDX) with a research period from 2016 to 2018. The data samples used are manufacturing companies listed on the Indonesia Stock Exchange for the period 2016 to 2018 with a total of 158 companies.

The data collection method used in this study was purposive sampling method. Purposive sampling method is sampling data with certain information as criteria needed by researchers in their research (Sekaran and Bougie:2016).

#### Data Analysis Methods

The data analysis method used in this study uses several statistical test tools, namely descriptive statistics, data quality test, classic assumption test, and hypothesis testing (quantitative analysis). Data that has been collected will be processed using Eviews to test all hypotheses between each independent variables with the dependent variables. Testing hypothesis using following step:

1. Descriptive Statistics
2. Estimation of Panel Data Regression
  - a. Common Effect Model (CEM)
  - b. Fixed Effect Model (FEM)
  - c. Random Effect Model (REM)
3. Selection of Panel Data Regression Model
  - a. Chow Test
  - b. Hausman Test
  - c. Multiple Lagrange Test
4. Test of Classical Assumptions
  - a. Normality Test
  - b. Multicollinearity Test c Heteroscedasticity Test
5. Hypothesis Test
  - a. T-test
  - b. F-test
  - c. Coefficient Determination ( $R^2$ )

### ANALYSIS AND DISCUSSION

#### Descriptive Statistics

Descriptive statistical analysis is used to provide a general description of the data used. Descriptive analysis measurements were carried out on the Audit Committee (AC), Independence Board of Commissioner (IC), Institutional Ownership (IO), Managerial Ownership (MO), Accounting Conservatism (CON\_ACC) and Company Size (SIZE) variables as independent variables and Earnings Quality variables (EQ) as the dependent variable.



## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

Table 1. Descriptive Statistics

	EQ	AC	IC	IO	MO	CON_ACC	SIZE
Mean	0.946530	2.896552	35.43377	60.77598	10.07504	0.003833	28.06144
Median	1.039709	3.000000	33.33333	63.09278	2.853732	-0.012758	27.88330
Maximum	47.83266	4.000000	66.66667	94.01152	68.27549	0.892111	33.47373
Minimum	-67.86499	0.000000	0.000000	1.947525	0.001030	-0.181471	25.66354
Std. Dev.	10.81985	0.665329	13.01675	22.51958	14.83939	0.112896	1.580429
Observations	87	87	87	87	87	87	87

Notes ; EQ = Earnings Quality; AC = Audit Committee; IC = Independence Board of Commissioner; IO = Institutional Ownership; MO = Managerial Ownership; CON\_ACC = Accounting Conservatism; SIZE = Company Size

Source : Data Processed with Eviews 9, 2020.

### Selection of Panel Data Regression Model Chow Test on the Fixed Effect Model

Table 2. Chow Test Result

Redundant Fixed Effects Tests			
Equation: Untitled			
Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	1.676002	(28,52)	0.0533
Cross-section Chi-square	55.953983	28	<b>0.0013</b>

Source : Data Processed with Eviews 9, 2020.

Chow test results indicate that the probability of the chi-square cross section is 0.0013 smaller than alpha (0.05) so that  $H_a$  is accepted and  $H_0$  is rejected. Then the appropriate method in research and the best technique for conducting regression tests is the fixed effect method.

### Hausman Test on the Random Effect Model

Table 3. Hausman Test Result

Correlated Random Effects - Hausman Test			
Equation: Untitled			
Test cross-section random effects			
Test SummarDACC	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	17.891836	6	<b>0.0065</b>

Source : Data Processed with Eviews 9, 2020.

Hausman test results note that the probability of a random cross section on the model is 0.0065 smaller than alpha (0.05) so that  $H_a$  is accepted and  $H_0$  is rejected, so that means the right model for panel data regression is the fixed effect model.

### Hypothesis Test T-Test

Table 4. T-Test Result

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	331.8582	87.36198	3.798657	0.0004
AC	-2.889229	3.064762	-0.942725	<b>0.3502</b>
IC	-0.081204	0.078432	-1.035340	<b>0.3053</b>
IO	0.214633	0.093395	2.298121	<b>0.0256</b>
MO	0.199574	0.094003	2.123070	<b>0.0385</b>
CON_ACC	-31.39441	7.793141	-4.028466	<b>0.0002</b>
SIZE	-11.95295	3.216112	-3.716583	<b>0.0005</b>

Source : Data Processed with Eviews 9, 2020.

14

## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

Based on the table above, then:

a. Hypothesis 1 = (Audit Committee influences Earnings Quality)

T test results in table 4.13, show that the value of prob. Audit Committee variable > critical probability value ( $\alpha = 5\%$ ) of 0.3502 > 0.05, so the Audit Committee variable has no effect on Earnings Quality. The conclusion of research rejecting H1 means that the Audit Committee has no effect on Earnings Quality.

b. Hypothesis 2 = (Independence Board of Commissioner influences Earnings Quality)

T test results in table 4.13, show that the value of prob. Independence Board of Commissioner variable > critical probability value ( $\alpha = 5\%$ ) of 0.3053 > 0.05, so that the Independence Board of Commissioner has no effect on Earnings Quality. The conclusion of research rejecting H2 means that the Independence Board of Commissioner has no effect on Earnings Quality.

c. Hypothesis 3 = (Institutional Ownership influences Earnings Quality)

T test results in table 4.13, show that the value of prob. Institutional Ownership variable < critical probability value ( $\alpha = 5\%$ ) of 0.0256 < 0.05, so the Institutional Ownership variable influences Earnings Quality. The conclusion of the study accepting H3 means that Institutional Ownership influences Earnings Quality.

d. Hypothesis 4 = (Managerial Ownership influences Earnings Quality)

T test results in table 4.13, show that the value of prob. Managerial Ownership variable < critical probability value ( $\alpha = 5\%$ ) of 0.0385 < 0.05, so that the Managerial Ownership variable influences Earnings Quality. The conclusion of the study accepting H4 means that Managerial Ownership influences Earnings Quality.

e. Hypothesis 5 = (Accounting

Conservatism influences Earnings Quality) T test results in table 4.13, show that the value of prob. Accounting Conservatism variable < critical probability value ( $\alpha = 5\%$ ) of 0.0002 < 0.05, so that Accounting Conservatism variable influences Earnings Quality. The conclusion of the study accepting H5 means that Accounting Conservatism influences Earnings Quality.

f. Hypothesis 6 = (Company Size influences Earnings Quality)

T test results in table 4.13, show that the value of prob. Company Size variable < critical probability value ( $\alpha = 5\%$ ) of 0.0005 < 0.05, so the Company Size variable influences Earnings Quality. The conclusion of the study accepting H6 means that Company Size affects Earnings Quality.

### F-Test

**Table 5. F-Test Result**

R-squared	0.525565	Mean dependent var	0.129989
Adjusted R-squared	0.215358	S.D. dependent var	3.455125
S.E. of regression	3.060550	Akaike info criterion	5.365000
Sum squared resid	487.0824	Schwarz criterion	6.357032
Log likelihood	-198.3775	Hannan-Quinn criter.	5.764461
F-statistic	1.694239	Durbin-Watson stat	2.394545
Prob(F-statistic)	<b>0.042368</b>		

Source : Data Processed with Eviews 9, 2020.

The F-statistic probability value is smaller than alpha (0.05), that is 0.042368 < 0.05 means that the Audit Committee (AC), Independence Board of Commissioner (IC), Institutional Ownership (IO), Managerial Ownership (MO), Accounting Conservatism (CON\_ACC) and Company Size (SIZE) simultaneously affect Earnings Quality (EQ), in other words the model used in this study is feasible / suitable.

16

### Coefficient of Determination (R<sup>2</sup>)

**Table 6. Coefficient of Determination (R<sup>2</sup>) Result**

R-squared	<b>0.525565</b>	Mean dependent var	0.129989
Adjusted R-squared	0.215358	S.D. dependent var	3.455125
S.E. of regression	3.060550	Akaike info criterion	5.365000
Sum squared resid	487.0824	Schwarz criterion	6.357032
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Prob(F-statistic)	0.042368		

Source : Data Processed with Eview 9, 2020.

## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

The results of the coefficient of determination in table 4.15 above, indicate that the value of R-Squared ( $R^2$ ) is 0.525565. This shows that the proportion of influence of the Audit Committee (AC), Independence Board of Commissioner (IC), Institutional Ownership (IO), Managerial Ownership (MO), Accounting Conservatism (CON\_ACC) and Company Size (SIZE) variables on Earnings Quality (EQ) by 52.56 percent while the remaining 47.44 percent (100 percent - 52.56 percent) is influenced by other variables not in the regression model. Variables that can influence Earnings Quality outside the regression model for example: Earnings Growth (Siti Wulandari, 2018), Investment Opportunity Set (Indah Lia Puspita, 2018), Cash Holding (Helina dan MeiryandanaPermanasari, 2017).

### CONCLUSION

Based on the results of the analysis and discussion described in the previous chapter, the conclusions in this study are:

1. Audit Committee has no significant effect to Earnings Quality.
2. Independence of Board Commissioner has no significant effect to Earnings Quality.
3. Institutional Ownership partially has positive significant effect to Earnings Quality.
4. Managerial Ownership partially has positive significant effect to Earnings Quality.
5. Accounting Conservatism partially has negative significant effect to Earnings Quality.
6. Company Size partially has negative significant effect to Earnings Quality.
7. Corporate Governance Mechanism, Accounting Conservatism, and Company Size simultaneously has significant effect to Earnings Quality.

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## The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality

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### **The Influence of Corporate Governance Mechanism, Accounting Conservatism, And Company Size on Earnings Quality**

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