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# The Effect of Good Corporate Governance on Profit Management (Case Study: Transportation Companies Listed on the IDX)

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***Abstract***.
Financial statements have the objective of presenting information related to financial condition and position, performance and changes in financial position that provide benefits to a large number of users of financial information, particularly profits that have been obtained. Finance is information that shows the company's achievement in generating profits. Earnings information is a part / component of the company's financial statements that aims to inform management performance, helping to estimate representative earnings capacity in the long term. This study aims to determine the effect of Independent Commissioners, Audit Committee, Institutional Ownership, Auditor Quality and Profitability on earnings management in transportation companies listed on the Indonesia Stock Exchange. This type of research is a causal quantitative research located on the Indonesia Stock Exchange (IDX) which is accessed through www.idx.co.id with a sample size of 5 companies during the 2015-2019 period using panel data linear regression analysis. The results showed that through the Chow and Hausman tests the fixed effects model (FEM) was used. The results of the t test show that partially the Independent Commissioner, Audit Committee, Institutional Ownership, Auditor Quality have an effect on Earning Management. Simultaneously the Independent Commissioner, Audit Committee, Institutional Ownership, Auditor Quality have an effect on Earnings Management.

**Keywords** : Good Corporate Governance and Earnings Management.

## INTRODUCTION

Profit management is an *agency theory* that is often triggered by the separation of roles and differences in interests between owners (shareholders) and company managers (management). As a company manager, management has more internal company information, faster, and more accurate than shareholders, so that management has the opportunity to practice accounting with an orientation to profit figures that can create a certain impression (achievement).

The profit management practice carried out by PT Garuda Indonesia (Persero) Tbk has caused major problems (Huda, 2019). PT Garuda Indonesia (Persero) Tbk in the third quarter of 2018 had a deficit of around Rp.1.64 trillion, suddenly a profit of almost Rp.72.6 billion at the end of 2018. The profit to be obtained on the 15-year contract

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amounted to Rp. 72.6 billion, all of which was recorded as the company's revenue for 2018. The recognition of income from Mahata's contract is contrary to Financial Accounting Standards Guidelines (PSAK) No. 23 on Income.

Sulisyanto (2008) in sirait (2015) stated that managers' behavior in carrying out excessive profit management can be minimized by implementing *good corporate governance* mechanisms. The *good corporate governance* mechanism has several indicators such as an audit committee, an independent board of commissioners and institutional ownership. The Audit Committee is established by an independent board of commissioners to assist in carrying out supervisory functions on the performance of the board of directors and management team in accordance with GCG principles. The Independent Board of Commissioners is the company's organ whose task is to ensure the implementation of the company's strategy, supervise management in managing the company and require the implementation of accountability. Sylvia and Sidharta in Sirait (2015) stated "Institutional ownership is the ownership of company shares by financial institutions such as insurance companies, banks, pension funds, and *investment banking.* Agoes (2014:203) "The quality of the auditor is a possibility that the auditor will find and report the errors he finds and freedom is considered compromised if the auditor does not report the error".

Christiani and Nugrahanti (2014) stated "Big-4 KAP provides more human resources for *staff training* and skill development in certain industrial fields than *non-Big-4 KAP".* Sartono in Herni and Susanto (2008) stated "A high level of profitability indicates that the company's performance is good and supervision is running well, while with a low level of profitability it indicates that the company's performance is not good and management performance looks bad in the eyes of *the principal".*

Profit management is the act of management to choose accounting policies from a certain standard with the aim of maximizing the welfare or value of the company (Ryan, 2011). The main role of an auditor is to provide an independent and objective review of the financial statements (Messier et al. 2006). De Angelo (1981) defines audit quality as the combined probability of an auditor's ability to find a violation in a client's financial reporting and report the violation. A quality audit will limit profit management so that financial statements can be relied upon and accounted for. Research by Welvin and Arlen (2010) shows that audit quality has a positive effect on profit management. Meanwhile,

e-ISSN: 2963-3370; p-ISSN: 2963-3656, Hal 495-507

Fajar (2015) stated that there was no significant influence on audit quality on profit management. The Audit Committee is an important mechanism in corporate governance (Zhang et al (2007), Anderson et al (2004), and has an important role in ensuring the quality of financial statements (Carcello and Neal, 2000). Research by Priyanto (2010) and Gradiyanto (2012) states that audit committees have a positive effect on profit management. Meanwhile, according to research by Lin et al (2006) proved that there is a negative influence between the audit committee and profit management (*discretionary accrual*)).

Then profitability is a measure used to assess a company capable of making a profit. The greater the level of profitability of a company, the greater the company's managers carry out profit leveling practices (Prasetya and Rahardjo, 2013). Profitability in this study was measured using Return On Asset (ROA). Nasihah (2015) stated that profitability has a positive effect on profit management practices, while Larinka (2015) shows that profitability has no effect on profit management. From the statement above, the researcher aims to analyze the indicators of *good corporate governance* that affect profit management in transportation companies listed on the IDX.

## LITERATURE REVIEW

Agency theory describes the relationship between *shareholders* as principals and management as agents. Management is a party that is contracted to work for the benefit of shareholders and has flexibility in carrying out company management. Jensen and Meckling in 1976. Jensen and Meckling (2012) in Sirait (2015) posit *A contract under which one or more persons (the principal/s) engage another person (the agent) to perform some service on their behalf which involves delegating some decisions making authority to the agent. If both partners to relationship are utility maximizers there is good reason to believe that the agent will not always act in the best interest of the principal.*

Schipper (2011) in Sirait (2015) posits "Profit management is a deliberate intervention in the external reporting process with a view to obtaining some personal gain". The understanding that can be taken that profit management is an effort by company managers to intervene or influence information in financial statements with the aim of deceiving *stakeholders* who want to know the performance and condition of the company. Sulistyanto (2008) in Sirait (2015) stated that "The term intervention and deception is used as a basis for some parties to assess profit management as fraud".

*The World Bank* in Mardiasmo (2018:18) explained that "GCG is as an implementation of solid and responsible management that is in line with the principles of democracy and efficient markets, avoidance of mis-allocation of investment funds, and prevention of corruption both politically and administratively, carrying out budget discipline and creating *a legal and political framework* for the growth of business activities". Monks in Khalil (2016:04) defines *Good Corporate Governance* "It is a system that regulates and controls companies that creates *value added* for all *stakeholders.* FCGI (2001) in Sirait (2015) states that "*Corporate governance* as a set of regulations that regulate the relationship between shareholders, company administrators, creditors, government, employees and other internal and external stakeholders related to their rights and obligations, or in other words a system that regulates and controls the company".

Beasley (1996) in Yunianto (2013) suggests that companies that commit fraud have a lower percentage of independent commissioners. In accordance with the Decree of the Head of Bapepam No.Kep. 29/PM/2004 "Audit Committee is a committee established by the board of commissioners of a company whose members are appointed and dismissed by the board of commissioners". In addition, the audit committee is an additional committee that aims to supervise the process of preparing the company's financial statements to avoid fraud on the part of management. The audit committee also functions to provide views on issues related to financial policy, accounting, and internal control of the company (Diantari and Ulupui, 2016). The Indonesia Stock Exchange (IDX) requires at least a three-member audit committee (Pohan, 2008 in Diantari and Ulupui, 2016). Members of the audit committee are required to have sufficient expertise. Jensen and Meckling (1976) in Yunianto (2013) stated that "Institutional ownership has a very important role in minimizing agency conflicts that occur between the *principal* and the *manager*".

The existence of institutional investors is considered capable of being an effective *monitoring* mechanism in every decision made by managers. Agoes (2014:203) argues that the quality of the auditor is "A possibility that the auditor will find and report the errors he finds and freedom is considered compromised if the auditor does not report the error". Hermanto (2015:118) explains that "Profitability is the net end result of various policies and decisions that will give the final answer about the effectiveness of company management. Munawir (2010:14) explains "The profitability ratio measures the overall

e-ISSN: 2963-3370; p-ISSN: 2963-3656, Hal 495-507

effectiveness of management which is indicated by the size of the profit processed in relation to sales and investment".

## RESEARCH METHOD(S)

This type of research uses causal research methods. The research place used is a transportation company listed on the Indonesia Stock Exchange (IDX) which is accessed through www.idx.co.id. The population in this study is a sub-company of transportation listed on the Indonesia Stock Exchange (IDX) as many as 16 companies. The observation period taken is 2015-2019. So that the research sample of 5 transportation companies with sampling techniques met the criteria. The data required in this study are secondary data which includes independent commissioners, audit committees, institutional ownership, auditor quality, profitability, and other financial statements that support this research data. The analysis technique used in this study used panel data regression analysis techniques using the help of the Eviews 7 application. The stages of data analysis are carried out with stages are estimation of panel data regression models, namely CEM, FEM and REM, ( Panel Data Regression Specification Test (Chow Test, Hausman Test and *Lagrange Multiplier* Test*),* Hypothesis Test (Partial Test, Simultaneous Test and Determination coefficient test).

## FINDINGS AND DUSCUSSION

The results of this study use proximityin estimating a model from panel data, namely a model without individual influence (common effect model) and a model with individual influence *(fixed effect model and random effect model).*

a. Model Selection with Chow Test

The results of testing the model using chow test data can be seen in the following table:

Table 1. Chow Test Results

Redundant Fixed Effects Tests
Equation: Untitled
Test cross-section fixed effects

| Effects Test | Statistic | d.f. | Prob. |
|---|---|---|---|
| Cross-section F | 122.867481 | (4,15) | 0.0000 |
| Cross-section Chi-square | 87.985368 | 4 | 0.0000 |

Source : Data Processed, 2022

Based on Table 1, it is known that the probability value is 0.0000. Because the probability value is 0.0000 < 0.05, the estimation model used is *Fixed Effect* Model (FEM).

b. Model Selection with Hausman Test

The results of testing the model using the Hausman test can be seen through the following table:

**Table 2. Hausman Test**

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

| Test Summary | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob. |
|---|---|---|---|
| Cross-section random | 10.353600 | 5 | 0.0349 |

2

Source : Data Processed, 2022

Based on Table 2 it is known that the probability value is 0.0349. Because the probability value is 0.0349 < 0.05, the estimation model used is *Fixed Effect* Model (FEM). Then alinear regression of Panel Data was performed using the *Fix Effect Model* (FEM) method. The following Linear regression table of panel data is

**Table 3. Panel Data Regression**

Dependent Variable: ML
Method: Panel Least Squares
Date: 05/06/21 Time: 15:50
Sample: 2015 2019
Periods included: 5
Cross-sections included: 5
Total panel (balanced) observations: 25

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|---|---|---|---|---|
| C | 3.559712 | 0.404216 | 8.806470 | 0.0000 |
| KI | -0.278583 | 0.044251 | -6.295548 | 0.0000 |
| KA | -0.037284 | 0.013433 | -2.775678 | 0.0061 |
| KIN | 0.000974 | 0.000863 | 1.128256 | 0.2607 |
| KUA | -0.143615 | 0.094452 | -1.520506 | 0.1492 |
| PT | 0.256902 | 0.438728 | 0.585560 | 0.5669 |

Effects Specification

Cross-section fixed (dummy variables)

| | | | |
|---|---|---|---|
| R-squared | 0.976315 | Mean dependent var | 0.141000 |
| Adjusted R-squared | 0.962104 | S.D. dependent var | 0.350399 |
| S.E. of regression | 0.068212 | Akaike info criterion | -2.243225 |
| Sum squared resid | 0.069793 | Schwarz criterion | -1.755675 |
| Log likelihood | 38.04032 | Hannan-Quinn criter. | -2.108000 |
| F-statistic | 68.70154 | Durbin-Watson stat | 2.321474 |
| Prob(F-statistic) | 0.000000 | | |

Source : Data Processed, 2022

Based on Table 3 that the panel data regression analysis equation is as follows :

Y = 3.559712 - 0.278583KI - 0.037284KA + 0.000974KIN + 0.143615KUA + 0.256902PT

Furthermore, from table 3, it can be seen that the partial test results in this study are the variable Independent Commissioner obtained a coefficient value of -0.278583 with a probability value of 0.0000 it is concluded that the Independent Commissioner partially has a negative and significant effect on profit management in transportation companies listed on the Indonesia Stock Exchange. The Audit Committee variable obtained a coefficient value of -0.037284 with a probability value of 0.0000 concluded that the Audit Committee partially had a negative and significant effect on profit management in transportation companies listed on the Indonesia Stock Exchange. The Institutional Ownership Variable obtained a coefficient value of 0.000974 with a probability value of 0.2607 concluded that Institutional Ownership partially has no effect on profit management in transportation companies listed on the Indonesia Stock Exchange.

The Auditor Quality Variable obtained a coefficient value of -0.143615 with a probability value of 0.1492 concluded that auditor quality partially has no effect on profit management in transportation companies listed on the Indonesia Stock Exchange. Variable Profitability obtained a coefficient value of 0.256902 with a probability value of

0.5669 it is concluded that Profitability partially Profitability has no effect on profit management in transportation companies listed on the Indonesia Stock Exchange.

Furthermore, from table 3, it can be seen that the results of simultaneous tests in this study were obtained a calculated F value of 68.70154 with a probability of 0.000000< 0.05 that all independent variables together have a significant effect on dependent variables, namely the Independent Commissioner, Audit Committee, Institutional Ownership, Auditor Quality and Profitability has a significant effect on profit management in transportation companies listed on the Indonesia Stock Exchange. And the value of the coefficient of determination (Rsquare) is 0.976315. The magnitude of the coefficient of determination of 0.976315 is equal to 97.63%. So it can be concluded that the ability of independent variables in explaining dependent variables is very strong and together has an influence contribution to independent variables, namely 97.63%. The remaining 2.37%. explained by other variables or factors outside of this study, namely these factors include leverage on the size of the company and such as capital structure.

The discussion in this study is that Profit management as "the goal of open disclosure of management in the external reporting process, with the benefit of personal gain". Profit management is something that happens when managers make an assessment in the structuring of transactions and financial reporting. The Independent Commissioner showed that it partially had a negative and significant effect on profit management as a result of this analysis supported by the results of previous research conducted by Praditia (2010) where significantly the Independent Commissioner showed that it partially had a significant effect on profit management. This shows that the members of the board of commissioners have acted actively and have carried out their supervisory role well with the board of directors. That way the Board of Commissioners can be sure to be very useful.

The board of commissioners who have the ability, and have shown their independence. And it can also be explained, that independent commissioners affect profit management, arguing that the appointment of independent commissioners by the company is not only limited to fulfilling regulations but also intended to uphold *good corporate governance* within the company. Then the relationship with the *agency theori* Where with the existence of an independent Commissioner who supervises the management of the company, it can reduce the level of profit management. The effectiveness of the board of commissioners in carrying out its role can be seen from the activities, number of members, independence and competence of the board of commissioners. Therefore, if the board of commissioners in carrying out its functions effectively, it can find indications of profit management practices carried out by managers.

The Audit Committee partially negatively and significantly affects profit management. The results of this analysis do not support the results of previous research conducted by Aji (2012) where it was found that the audit committee did not have a significant effect on profit management. This shows that in other words, the size of the audit committee has proven to be affected by profit management. This happens because the company's goal of forming an audit committee is not just to comply with government regulations. And members of the audit committee have actively carried out their duties as an audit committee so that the supervisory function can run well.

Then it is connected with *theori agencies* where the Audit Committee plays an important role in the quality and credibility of financial statements, because they act as part of a governance mechanism to improve the company's operations and economic benefits. The Audit Committee is an important mechanism in corporate governance. An independent Audit Committee is required in monitoring profit management. The role of monitoring will be stronger with the involvement of qualified auditors. therefore The auditor's function is to ensure that the financial information presented meets accounting standards. External auditors can improve the effectiveness of internal control through coordination with the internal audit function and the audit committee.

Institutional ownership partially has no effect on profit management the results of this analysis support the results of previous research conducted by Simamora (2011) where institutional ownership has a significant effect on profit management. This suggests that the existence of institutional ownership causes managers to feel linked to meeting investors' profit targets, so managers will still be less likely to engage in profit management actions. As a result, management may be triggered to take actions that will increase short-term profits, for example by manipulating profits. And this is because some institutional investors are *transient investors* who are more focused on *current earnings* and there are still many institutions that are less active in putting pressure on management activities, lack of institutional supervision of the work of the management. Then there is a reason that institutional ownership indicated by the size of share ownership in the company does not change management's behavior in carrying out real profit management practices, this also shows the institutional's inability to control management through the monitoring process so that the supervision process carried out becomes less effective, so it cannot reduce the management in carrying out real profit management practices.

Then the relationship with *agency theory* is where institutional ownership has the ability to monitor the performance of managers in managing the company so that with ownership by other institutions it is expected to reduce the behavior of profit management carried out by managers. Institutional investors are those who can monitor agents with large holdings, so that the manager's motivation to manage profits is reduced.

The quality of auditors partially has no effect on profit management. The results of the analysis do not support the results of previous research conducted by Aji (2012) where the quality of auditors affects profit management. This shows that its reputation has not been able to provide better audit quality assurance, so there is a possibility that it cannot prevent issuers from cheating in presenting irrelevant financial statements to the public. Although auditors have the ability and expertise in the field of accounting and auditing who are able to objectively assess auditing a financial statement and there is a possibility that they lack an understanding of accounting and auditing so that they cannot detect profit management practices carried out by managers. Then the relationship with the *agency* is where the high quality of audits is expected to reduce the occurrence of this manipulation and provide maximum results, one of which is in the form of relevant and credible financial statements that can be useful for stakeholders, only qualified auditors who can guarantee that the reports (information) it produces are reliable. It is undeniable that the company's financial statements will be audited by auditors who have different qualities.

Profitability partially has no effect on profit management. The results of this analysis do not support the results of previous research conducted by Cahya and Oky (2018) where profitability partially has a significant effect on profit management. This shows that the higher or lower the profitability obtained by the company has no effect on profit management. This is due to the higher the profitability, the smaller the dividends distributed. Increasing profitability indicates good company performance and shareholders will receive increasing profits. Because the manager also earns a profit so that he does not carry out profit management actions.

Then the relationship with *theori agency* is where profitability is the net result of a series of policies and decisions. To be able to maintain its survival, a company must be in a favorable state. In the absence of profit it will be very difficult for the company to attract outside capital. Creditors, company owners and especially the management of the company will try to increase this profit, because it is well realized how important profit means for the future of the company.

## CONCLUSION AND RECOMMENDATION

The conclusion obtained is through model testing that using the Fix Effect Model (FEM) model is the best model for this research. Independent Commissioner partially has a negative and significant effect on earnings management, Audit Committee partially has a negative and significant effect on earnings management, Institutional Ownership partially has no effect on earnings management, Auditor Quality partially has no effect on earnings management and partially Profitability has no effect on earnings management in transportation companies listed on the Indonesia Stock Exchange in 2015-2019. Independent Commissioners, Audit Committees, Institutional Ownership, Auditor Quality and Profitability in the R-Square coefficient value shows that the ability of the independent variable is very strong and together it has a contribution of influence on the independent variable which is equal to 97.63%. Suggestions that can be conveyed are that the management of the company is expected that the results of this study can become an evaluation in assessing the earnings management of each company. In addition, company management can take corrective action if there is a decrease in performance or profits in the company they lead. Then the issuers are advised to further improve the company's performance as a whole in all aspects so that it can develop the company even better, especially in terms of company profit management.

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Research is useful for future researchers and companies and can be further developed by different research models so that they can develop theories according to technological developments.

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