THE INFLUENCE OF INFORMATION ASYMMETRI AND CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT
(Study Of listed companies in Indonesia Stock Exchange)

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ABSTRACT

The purpose of this research is to find out the influence of asymmetry information and mechanisms of corporate governance towards earnings management. There were 89 companies of manufacturing sector in Indonesia stock exchange in which using purposive sampling method, which published in the financial report of 2007 until 2010. Asymmetry information measured by bid-ask spread, mechanisms of corporate governance measured by factor score. While the proxy of earnings management measured by discretionary accruals which is divided into short-term and long-term discretionary accruals (Whelan dan McNamara, 2004). The theory underlying this research is agency theory. By using multiple regression analysis, this study proved that asymmetry of information and mechanisms of corporate governance have the significant influence towards the earnings management both in short-term and long-term discretionary accruals. This result indicates that implementation of corporate governance in Indonesia companies effective in reducing behavior of opportunist management such as earnings management.

Keywords: Asymmetry of Information, Mechanisms of corporate governance, Earnings Management

JEL: G34, G32

I. Background

Earnings management is a management tool to influence earnings numbers with selecting accounting policies and accounting procedures specific to the goal of maximizing the ability of managers and or the market value of the company (Scott, 2000:351). Earnings management appeared or performed by a manager in the financial reporting process of an organization because they expect a benefit from the actions taken.

Rahmawati et al. (2006) stated that the agency theory (agency theory) implies the existence of information asymmetry between management (agents) and owners (principal). Information asymmetry arises when the manager is better informed and prospects of the company in the future compared to shareholders and other stakeholders. When information asymmetry is high, stakeholders do not have enough resources, incentives, or access to information that is relevant to monitor the actions of managers (Richardson, 1998).

This will encourage managers to present information that is not true, especially if the information relates to the measurement of the performance of managers. Therefore, the existence of information asymmetry are considered to provide an opportunity for managers to perform earnings management. The ability of management to manage earnings may be reduced by providing more quality information to outside parties.

Earnings management actions have led some cases accounting reporting scandals that are widely known. In 2001, a financial scandal occurred in a public company in Indonesia, which involves the manipulation of financial statements by PT Lippo Tbk and PT Kimia Farma Tbk. (Boediono, 2005). It is proved that the practice of manipulation of financial statements is still being done by the corporate parties. One cause of this condition is the lack of good corporate governance. Weak corporate governance practices at some companies in Indonesia will lead to decision-making and inefficient corporate actions.

Application of corporate governance is a concept that is expected to serve as a tool to improve corporate performance through supervision or monitoring management performance and ensure the accountability of management to stakeholders by basing the regulatory framework (Nasution and Setiawan, 2007).

The implementation of the concept of corporate governance aims to achieve a more transparent management for all users of financial statements. When this concept is applied correctly, it is expected that economic growth will continue to increase in line with the transparency of corporate governance and a better benefit many parties. Veronica and Main (2005) stated that the system of corporate governance in companies believed to limit opportunistic earnings management.

Based on the above description of the background, then the problem can be formulated in this study is: Does information asymmetry and corporate governance mechanisms influence the practice of earnings management?

II. Previous research and hypothesis development

1. Previous Research

Several studies related to information asymmetry, corporate governance and earnings management has been carried out such as:

Richardson (1998) conducted a study on the relationship of information asymmetry on earnings management company listed on the New York Stock Exchange from 1988 to 1992 period. The results of the study suggested that there is a relationship between the level of information asymmetry and earnings management. This result is also supported by Rahmawati et al. (2006) conducted the study on the Banking Indonasia listed on the Stock Exchange in 2000-2004. The results of the study indicate that information asymmetry is a significant positive effect on earnings management.

Chtourou et al. (2001) conducted a study on the effect of corporate governance on earnings management for companies listed on the New York Stock Exchange. The results of this study that the characteristics of the audit committee and board of directors is negatively related to earnings management. Boediono (2005) using the method of path analysis to determine the effect of corporate governance mechanisms are represented by institutional ownership, managerial ownership and the composition of the board of commissioners on earnings management and earnings quality. The results of the study showed that the effect of corporate governance variables simultaneously weak enough to earnings management, as well as a partial influence. A similar study conducted by Aji (2008) regarding the effect of corporate governance on earnings management in companies listed on the Jakarta Stock Exchange since 2001 and announces financial statements the period 2002-2007. The results of this study indicate that corporate governance significantly affect earnings management.

Last, research Primayanti (2009). examine the effect of corporate governance and information asymmetry on earnings management and earnings quality. The results of this study indicate that managerial ownership and information asymmetry significant effect on earnings management practices. The study also found that the mechanism of corporate governance (managerial ownership) does not affect the quality of earnings.

This study examines the effect of information asymmetry and corporate governance mechanisms on earnings management. The difference of this study lies in the measurement of earnings management. Previous studies using the method of John (1991), whereas this study uses methods Whelan and McNamara (2004). In the method of John (1991) contains a weakness that is too short-term focused, so we need a separation of components of discretionary accruals into short-term, long-term and total discretionary accruals as used method Whelan and McNamara (2004).

2. Hypothesis Development

The relationship between Information Asymmetry and Earnings Management Practice

Information asymmetry is considered as one of the causes of earnings management (Rahmawati et al, 2006). Information asymmetry occurs because the management have more access to information than the company's investors. This gives management the opportunity to manage earnings in accordance with expectations. Richardson (2003) states that there is a systematic relationship between the asymmetry of information with earnings management. This result is also supported by Halim et al. (2005) and Rahmawati et al (2006) which indicates a positive effect of significant information asymmetry on earnings management. This means that the higher the information asymmetry, the higher the chance is owned by management in conducting earnings management practices. Based on the above, the hypothesis that will be tested in this study are:

H1: information asymmetry effect on earnings management practices.

The relationship between corporate governance mechanisms and Earnings Management Practice.

Corporate governance is a concept that is based on agency theory. Corporate governance is expected to serve as a tool to provide confidence to investors that they will get a return on the funds invested. According to Shleifer and Vishny (1997) in Ujiyanto and Scout (2006) stated that corporate governance to assure investors that the manager will give advantage to them and the manager will not steal, embezzle or invest funds in projects that are not profitable. So with corporate governance, investor can control the managers.

Nasution and Setiawan (2007) stated that corporate governance affect earnings management . However, contrary to the results of research Sefiana (2009) which states that corporate governance has no effect on earnings management. This means that the implementation of corporate governance in a company is not necessarily free from management actions do earnings management . So it takes the board of commissioners and directors of the company which is the organ that has an important role in implementing good corporate governance effectively (NCG , 2006: 11) . Both boards are also assisted by the audit committee to monitor the financial reporting process that is expected to prevent the manipulation by the management company . This study examines the use of factor scores commissioners , the audit committee , management and

shareholders in corporate governance as a variable to test its effect on earnings management practices . In this research, the formulation of the hypothesis as follows :
H2: The negative effect of corporate governance mechanisms on earnings management practices.

3. Methods

Sample

The population of this research is all the companies listed in Indonesia Stock Exchange during the period 2007-2010. While the sampling is done by using a purposive sampling method. The criteria used in selecting the sample is as follows:
1). The company that publishes an annual report for the year 2007-2010. 2). The Company does not delisting of Indonesia Stock Exchange so that it can continually trade on the Stock Exchange during the period of estimation. 3). Has the necessary data and information in the study. From the above criteria sample collected as many as 89 companies per year or 356 firm years

Operational definitions

a. information asymmetry

Information asymmetry is a condition in which one party to a business transaction has more information than the other party. Information asymmetry measurements in this study using the relative bid ask spread, as used Rahmawati (2006).

SPREAD = (askt – bidt) / {(askt + bidt) / 2} x 100...................................(9)

Askt : highest asking price of company stock that occurred on day t
Bidt : lowest bid price of the company stock that occurred on day t
Relative value of the bid ask spread using the ratio scale. The higher the relative value of the bid ask spread, the higher the possibility of asymmetry of information within the company.

b. Good Corporate Governance Mechanism (GCG)

In this research by being in line with Klapper and Love (2002), Ali syah, Butt and Hasan (2009), wahidahwati (2012) the quality of corporate governance mechanism (CG) has been estimated by the use of following equetion.
GCG = f (BOC, AC, D, I).

BOC = Board Of Commisionaire
M = Management
AC = Audit Committee
I = Investor
Above diagram represents the theoretical frame work for the measurement of quality of Good Corporate Governance. In each of company above mentioned functions has been identified and on the fulfillment of codes and literature's criteria marks has been assigned to each company. Each function has been given a weight on the basis of its importance as far as control on earnings management is concerned. After allocating the marks and getting their respective weights, weighted mark have been calculated. To obtain the aggregate score of each company calculated weighted marks have been summed up. Criteria and form used for measuring of corporate governance mechanism is attached in appendix 1.

c. Earnings Management

Earnings management can be measured by discretionary accruals (DA). This study calculates discretionary accruals (DA) using a model of Whelan and McNamara (2004) which is a development of the older models, like the model of Jones (1991) and Dechow (1994). Old models are used in calculating earnings management contains a weakness that is too short-term focus (Whelan and McNamara (2004). To overcome this problem, it is necessary to separate short-term and long-term and total discretionary accruals.

Before using the model of Whelan and McNamara (2004), first calculate the total accruals:

$ACC_{i,t} = EARN_{i,t} - CFO_{i,t}$ ....(11)

ACCi,t : Total accruals for firm i in period t

EARNi,t : Net income for firm i in period t

CFOi,t : Cash flow from operating activities of firm i in period t

1). Short-term accruals in Dechow (1994) and Whelan and McNamara, (2004) is defined as follows:

$STACC_{i,t} = \Delta AR_{i,t} + \Delta INV_{i,t} + \Delta OCA_{i,t} - \Delta AP_{i,t} - \Delta TXP_{i,t} - \Delta OCL_{i,t}$..........(12)

STACCi, t : Short-term accruals for firm i in year t

ΔARi, t : Difference of receivables of year t and year t-1 of firm i

ΔINVi, t : Difference of inventories in year t and year t-1 of firm i

ΔOCAi, t : Differences from Other current assets in year t and year t-1 of firm i

ΔAPi, t : Difference of trade payables at year t and year t-1 of firm i

ΔTXPi, t : Difference of tax payable in year t and year t-1 of firm i

ΔOCLi, t : Differences from Other current payables to know t and year t-1 of firm i

2). Expected Short-term accruals for industry measured by income component of the model of Jones (1991).

$$\frac{STACC_{i,t}}{TA_{i,t-1}} = \gamma_1\left(\frac{1}{TA_{i,t-1}}\right) + \gamma_2\left(\frac{\Delta REV_{i,t}}{TA_{i,t-1}}\right) + \varepsilon_{i,t} \qquad \text{...(13)}$$

$STACC_{i,t}$: Short-term accruals for firm i in year t

$TA_{i,t-1}$: Total assets of firm i in year t-1

$\Delta REV_{i,t}$: Revenues in year t minus earnings in year t-1 firm i

$\varepsilon_{i,t}$: Error for firm i year t

From the regression equation above, short-term discretionary accruals (STDACC) can be calculated by entering again the coefficient of the regression (ɣ1, ɣ2) in equation 14:

$$STDACC_{i,t} = \frac{STACC_{i,t}}{TA_{i,t-1}} - \left[g_1\left(\frac{1}{TA_{i,t-1}}\right) + g_2\left(\frac{\Delta REV_{i,t}}{TA_{i,t-1}}\right)\right] \qquad \text{...............................(14)}$$

4.) Total accruals company is the sum of short-term and long-term discretionary accruals, so that long-term accruals are the difference between total accruals with short-term accruals.

$LTACC_{i,t} = ACC_{i,t} - STACC_{i,t}$ ....(15)

LTACCi,t : Long-term accruals for firm i in year t

Acci,t : Total Accruals of firm i in year t

STACCi,t : Short-term accruals for firm i in year t

5.) Furthermore Models Jones (1991) is used to estimate the total discretionary accruals by the formula:

$$\frac{ACC_{i,t}}{TA_{i,t}} = \varphi_1\left(\frac{1}{TA_{i,t}}\right) + \varphi_2\left(\frac{\Delta REV_{i,t}}{TA_{i,t-1}}\right) + \varphi_3\left(\frac{PPE_{i,t}}{TA_{i,t-1}}\right) + \varepsilon_{i,t} \quad ....(16)$$

$ACC_{i,t}$: Accrual firm i in year t (obtained from equation 1)

$TA_{i,t-1}$: Total assets of firm i in year t-1

$\Delta REV_{i,t}$: Difference of income in year t and year t-1 to firm i

$PPE_{i,t}$: The fixed assets of firm i in year t

$\varepsilon_{i,t}$: Error for firm i year t

From the regression equation above, it is assumed that describe non-discretionary accruals can be calculated by re-inserting the coefficients (φ1, φ2, φ3), the difference between the above estimates with actual accruals considered as total discretionary accruals, DACC:

$$\text{DACC}_{\text{i,t}} = \frac{ACC_{i,t}}{TA_{i,t-1}} - \left[j_1\left(\frac{1}{TA_{i,t-1}}\right) + j_2\left(\frac{\Delta REV_{i,t}}{TA_{i,t-1}}\right) + j_3\left(\frac{PPE_{i,t}}{TA_{i,t-1}}\right)\right] \quad ....(17)$$

6.) Then estimate the long-term accruals expectations formed by the variable land, plant, equipment, intangible and non-current provisions.

$$\frac{LTACC_{i,t}}{TA_{i,t-1}} = \eta_1\left(\frac{1}{TA_{i,t-1}}\right) + \eta_2\left(\frac{PPE_{i,t}}{TA_{i,t-1}}\right) + \eta_3\left(\frac{INT_{i,t}}{TA_{i,t-1}}\right) + \eta_4\left(\frac{NCP_{i,t}}{TA_{i,t-1}}\right) + \varepsilon_{i,t} \quad ....(18)$$

$LTACC_{i,t}$: Long-term accruals for firm i in year t

$TA_{i,t-1}$: Total assets of firm i in year t-1

$PPE_{i,t}$: The fixed assets of firm i in year t

$INT_{i,t}$: Intangible firm i end of year t-1

$NCP_{i,t}$: Provisions not smooth firm i year t

$\varepsilon_{i,t}$: Error for firm i year t

The method of calculating the total and short-term discretionary accruals, is still used in measuring long-term discretionary accruals, LTDACC:

$$\text{LTDACC}_{\text{I,t}} = \frac{LTACC_{i,t}}{TA_{i,t-1}} - \left[h_1\left(\frac{1}{TA_{i,t-1}}\right) + h_2\left(\frac{PPE_{i,t}}{TA_{i,t-1}}\right) + h_3\left(\frac{INT_{i,t}}{TA_{i,t-1}}\right) + h_4\left(\frac{NCP_{i,t}}{TA_{i,t-1}}\right)\right] \quad ....(19)$$

If short-term discretionary accruals is 1 then there are indications of earnings management. While the value is 0 then there is no indication of earnings management. If long-term discretionary accruals is 1 then there are indications of earnings management. While the value is 0 then there is no indication of earnings management.

d. Control Variable : SIZE

Firm size is included as a control variable in the analysis because it has been found to be associated with various firm characteristics. Firm size is measured as log natural of the book value of total assets, which is logged to normalize the variable and labeled LNASSET.

4. Results

a. Descriptive Research

Based on the results of data processing by using SPSS, obtained descriptive statistics for the study variables that can be seen in the table below:

Table 1

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Asimetri Informasi (X1)	89	-50.0000	82.5095	17.715258	26.629298
GCG (X2)	89	32.3684	60.5263	43.867493	5.631839
Ukuran Perusahaan (X3)	89	10.2700	17.2000	13.450449	1.477689
Manajemen Laba STDACC (Y1)	89	-2.2572	1.8502	1.29E-02	.878986
Manajemen Laba LTDACC (Y2)	89	-1.6923	1.2742	4.16E-02	.300089
Valid N (listwise)	89				

In the above table shows that the amount of data used in this study were 89 samples of data. The average value of the variable short-term discretionary accruals (STDACC) is 0.0129 with an average degree of deviation of 0.88. The average value of short-term discretionary accruals is 1.85 and the highest average value of short-term lowest discretionary accruals is -2.25.

The average value of the variable long-term discretionary accruals (LTDACC) is 0.0416 with an average deviation rate of 0:30. The average value of long-term discretionary accruals is 1:27 and the highest average value of long-term lowest discretionary accruals is -1.69.

The average value of the information asymmetry variable rate is 17.72 with an average deviation of 26.63. The average value of the highest information asymmetry is 82.51 and the average value of the lowest information asymmetry is -50.

The average value of the variable firm size (SIZE) was 13:45 with an average deviation rate of 1.48. The average value of firm size (SIZE) is 17.2 and the highest value of the average firm size (SIZE) is the lowest 10:27.

The average value of the variable mechanism of corporate governance is 43.87 with an average degree of deviation of 5.63. The average value of the highest corporate governance mechanism is 60.53 and the average value of the lowest corporate governance mechanism is 32.37.

b. Test of the Classical Assumptions

Test classical assumptions consists of normality test, multikolinierity test, autocorrelation test and heterokedastisitas test, where everything is free from interference, so that hypothesis testing can be done.

c. Results of Regression

1. Results of Regression Model Short-Term Discretionary Accruals.

Tabel 2

Regression Results of Model Short-Term Discretionary accruals

Model	Unstandardized Coefficients		t test	Sig
	B	Std. Error		
Constant	0.003984	0.921	0.004	0.997

Information Assymetry	0.007655	0.004	2.161	0.034
Corporate Governance	0.03380	0.019	1.773	0.080
Firm Size	-0.120	0.076	-1.583	0.117
R = 0.336 F = 3.613	R Square = 0.113 Sig. = 0.016			

Based on the calculation above, the regression equation was obtained as follows:

Y = 0.003984 + 0.007655 AI + 0.03380 GCG - 0.120 Size + ei

Value of the correlation coefficient (R) indicates how closely the relationship between the independent variable (the variable information asymmetry, corporate governance, and firm size) with Short-term discretionary. This value indicates that the information asymmetry variable relations, corporate governance, and firm size with variable Short-term discretionary accruals is low as indicated by the value of 0,336.

coefficient of determination (R2) is used to measure how far the model's ability to explain variation in the dependent variable (short-term discretionary accruals). The results of the calculation, the value of R2 = 0.113, which means that it amounted to 11.3% Short-term discretionary accruals can be explained by the information asymmetry variables, corporate governance, and firm size. While the remaining 88.7% is influenced by other variables outside the model under study.

F-test to test the effect of independent variables which consist of information asymmetry, corporate governance, and firm size on short-term discretionary accruals. F-test was 3,621, a significance level of 0.016, so the conclusion that H0 is rejected, so it can be concluded that all the independent variables (information asymmetry, corporate governance, and firm size) significantly influence the dependent variable (short-term discretionary accruals).

Significance (t-test) of information asymmetry is 0.034, it can be concluded that H0 is rejected, this means that there is the influence of information asymmetry on earnings management via short-term discretionary accruals. These results are in line with research Richardson (1998), Rahmawati (2006) and Halim et al. (2005) that indicate a positive effect of information asymmetry on earnings management, which means that the higher the information asymmetry, the greater the level of earnings management. Information asymmetry is considered as one of the causes of earnings management. Schift and Lewn (1970) in Ujiyantho and Pramuka (2006) states that managers are in a position to have more information about the capacity of self, work environment, and the company as a whole in comparison with the shareholders).

t-test of the variable Corporate Governance at 0.086, it can be concluded that H0 is accepted, which means that corporate governance has no effect on earnings management via short-term discretionary accruals. This study contradicts the study conducted by Ujiyanto and Scout (2006), Restie (2010) which states that corporate governance significantly affect earnings management. This means that the implementation of corporate governance by the company may not necessarily have been freed from the practice of earnings management.

The significance of the size of the company is -0.117 , we can conclude that H0 is accepted, which means that the size of the company does not have a significant effect on earnings management via short-term discretionary accruals. These results are similar to studies conducted by Nasution and Setiawan (2007), Setiawan (2009), Permana (2010) which states that firm size does not significantly affect earnings management. Nonsignificant results could be explained because large companies usually have a role as a wide stakeholder so that more attention by the public . So that every policy undertaken by the company managers will be noticed by the general public. Instead the results of this study contrast with research conducted by Restie (2010) , Siregar and Main (2005) which shows that company size has a significant effect on earnings management . This means that the larger the size , the smaller the company indication of earnings management practices.

2. Analysis and Discussion of Model Long-Term Discretionary Accruals.

Regresion result of Model *Long-term Discretionary Accruals*

Tabel 3

Model	Unstandardized Coefficients		t-test	Sig
	B	Std. Error		
Constant	-0.415	0.310	-1.336	0.185
Asimetri Informasi	0.003208	0.001	2.688	0.009
Corporate Governance	0.01331	0.006	2.073	0.041
Firm Size	-0.0137	0.025	-0.539	0.592
R = 0.362		R Square = 0.131		
F_{-test} = 4.280		Sig. = 0.007		

Based on the results of the above calculation, the regression equation was obtained as follows :

$$Y = -0.415 + 0.003208\ AI + 0.01331\ GCG - 0.0137\ Size + ei$$

The correlation coefficient (R) shows the relationship between the independent variables (information asymmetry, corporate governance, and firm size). R = 0.362 indicates that the relationship between the independent variables (information asymmetry, corporate governance, and firm size) with the dependent variable (long-term discretionary accruals) is low.

The coefficient of determination (R2) = 0.131 which means that 13.1% of long-term discretionary accruals can be explained by the information asymmetry, corporate governance, and firm size. While the remaining 86.9% is influenced by other variables outside the model under study.

F-tes = 4:28, with a significance value is 0.007, it can be concluded that H0 is rejected. This result can be stated that all the independent variables (information asymmetry, corporate governance, and firm size) significantly influence the dependent variable (earnings management via long-term discretionary accruals).

Based on the results of SPSS unknown significance value of information asymmetry is 0.009, it can be concluded that H0 is rejected. These results indicate that the asymmetry of information significant effect on long-term discretionary accruals.

This means that high information asymmetry will result in a high chance that possessed by management in making earnings management via long-term discretionary accruals. In other words that the manager's actions can not be detected for some of the next accounting period (Whelan and McNamara, 2004 in Kusuma, 2006). Thus, managers are better able to estimate future earnings and will be communicated to investors or other owners of the financial statements. Managers can use discretionary accruals to reflect the company's performance through profit (Gut et al, 2003).

Significance value of GCG is 0.041, it can be concluded that H0 is rejected. These results are similar to studies conducted by Ujiyanto and Scout (2006), Restie (2010) which states that corporate governance significantly affect earnings management. This means that the implementation of corporate governance can effectively reduce the action of management conduct earnings management. Significance of firm size (SIZE) is 0.592, it can be concluded that H0 is rejected unsuccessful. The results of this study indicate that company size (SIZE) does not affect the long-term discretionary accruals. In other words, either large or small companies will avoid earnings volatility that occurs suddenly.

5. Conclusions and Recommendations

The results indicate that information asymmetry has a significant effect on earnings management through both short-term discretionary accrualsditemukan or through long-term accruals. Thus these results indicate that the difference of information between management and shareholders will be easier for management to manipulate the financial statements on reported earnings. In other words, these results reinforce the notion that the gap of information between agents (management) and the principal (shareholders) will affect the opportunistic nature of management to perform earnings management.

Application of corporate governance mechanisms on earnings management via short-term discretionary accruals has no significant effect. These results are not significant due to the short-term accruals have relatively short period of time in knowing whether the results of the application of corporate governance has been done well and perfect on the company. While the application of corporate governance mechanisms on earnings management via long-term discretionary accruals has a significant influence. This is because long-term accruals have a long period of time in knowing whether the results of the application of corporate governance has been done correctly. Richardson et al (2001) also mentions that the use of long-term accruals over the next information to the SEC (Securities Exchange Commisison).

Recommendation

1. For further study should add to the sample and extend the period of study in order to provide better results. Researchers are also expected to consider the following other variables that can affect earnings management practices.
2. For management, should avoid the practice of earnings management and deliver real business conditions in order not to harm the interested parties (stakeholders), especially investors.
3. For auditors, should be more careful in conducting the audit so that it can be ascertained that the financial statements are free from the possibility of earnings management practices both short-term and long-term discretionary accruals.

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