

Original Research Article

The Effect of Board Size of Directors and Commissioners, Board Gender Diversity, and Government Ownership on Earnings Management with Financial Performance as A Moderating Variable (Study on State-Owned Enterprises Listed on the Indonesia Stock Exchange Period 2018-2022)

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Abstract: This study aims to examine the effect of board size, gender diversity, and government ownership on earnings management with financial performance as a moderating variable. The population used in this study were state-owned companies listed on the Indonesia Stock Exchange with a total of 14 companies. The sample in this study used a *purposive sampling method* so that based on the selection results, 11 companies were obtained as samples in this study, with a research period from 2018 - 2022. Data analysis used in this study is panel data with multiple regression analysis methods and using the EVIEWS 12 application as a tool to determine the hypothesis. The results of the study indicate that board size has negative effect on earnings management, gender diversity has positive effect on earnings management, government ownership has negative effect on earnings management, financial performance is unable to moderate board size on earnings management, financial performance is able to moderate gender diversity on earnings management, and financial performance is able to moderate government ownership on earnings management.

Keywords: Earnings management, Board size, Gender diversity, Government ownership, Financial performance.

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1. INTRODUCTION

Indonesia State Owned Enterprises (ISOE) has a very strategic role, considering that ISOE is an extension of the government that functions as an agent of

state development. ISOE plays a large role in contributing to development and economic growth and also improving people's welfare. The fiscal contribution of ISOE to state revenues in 2017-2021 can be seen in the table below:

Fiscal Contribution of State-Owned Enterprises 2017-2021 (Rp. Trillion)

DESCRIPTION	2017	2018	2019	2020	2021
Dividend	43	44	50	44	30
Tax	190	211	245	285	247
Other PNB	82	100	166	136	86
Total	315	355	461	465	363

Source: Annual Report of the Ministry of SOEs 2021 (www.bumn.go.id)

The realization of state revenue in the 2021 State Budget is 2,011 trillion, while the fiscal contribution of ISOE in 2021 is 363 trillion, so ISOE contributes 18% of the total state revenue. In terms of achieving financial performance, the profits generated by

ISOE in 2017-2021 have generally decreased for 5 years, especially in 2020 which was the beginning of the Covid-19 pandemic. Before this pandemic, ISOE's net profit also decreased in 2019 by almost 20 trillion. This is as shown in the graph below:

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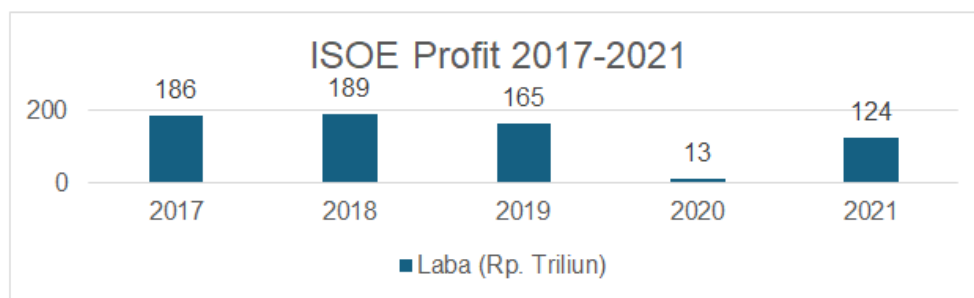


Figure 1.1: ISOE Profit 2017 – 2021

Source: Annual Report of the Ministry of SOEs 2017-2021 (www.bumn.go.id)

When a company does not achieve financial expectations such as profit, revenue, debt covenants, profitability, then the company can use flexibility to manipulate accounting figures (Tran, Tran, & Phan, 2022). Earnings management is a series of activities to manipulate financial statements. This arises because of the flexible principle that allows managers to use their authority in reporting profits (Schipper, 1989). Earnings management is the manipulation of profits to create a more positive picture of the company's performance. In developing countries such as Turkey, earnings management is an important concept for listed companies, accountants, auditors, and internal and external decision makers because profits are used as a proxy in the capital market to measure the success of the company (Turegun, 2016). Earnings management will reduce the quality and reliability of financial statements in the long term. As a result of excessive profit adjustments, accounting information becomes inaccurate, thus providing false information to users. In addition, earnings management only focuses on achieving maximum profits in the short term. This has nothing to do with improving product quality or improving the company's structure which can increase the possibility of financial difficulties in the future (Thu, 2023).

Based on the Indonesian Fraud Survey published by *the Association of Certified Fraud Examiners* in 2019, fraud in financial reporting is the third most common in Indonesia after corruption and misuse of assets (www.acfe-indonesia.or.id). One of the cases of profit manipulation carried out by a state-owned company is PT Garuda Indonesia (Persero) TBK, where Garuda's annual financial report in 2018 was declared flawed after it was discovered that Garuda Indonesia recognized revenue related to cooperation worth IDR 3.47 trillion carried out with PT Mahata Aero Teknologi for payments that Garuda would receive after signing the agreement so that this had an impact on Garuda's Profit and Loss Report. Several other state-owned companies involved in financial report profit manipulation are PT Jiwasraya, which is said to have manipulated financial reports since 2006. The profit recorded in Jiwasraya's financial report is said to be fake due to accounting engineering. In a press release issued by the Audit Board of Indonesia on Monday, March 9, 2020, it was

explained that this negligence caused a state loss of IDR 16.82 trillion, which was the value of stock and mutual fund investments whose acquisition was not in accordance with the provisions.

One of the factors that influence companies to practice earnings management is the characteristics of the board. The success of ISOE development and management is significantly determined by the success of placing the right talents as ISOE managers. ISOE as a business entity has three main organs, namely the General Meeting of Shareholders, the Board of Directors, and the Board of Commissioners. In this study, the measurement of board characteristics used is board size and board gender diversity. Common wisdom is that smaller boards will be more effective (Lipton and Lorsch, 1992; Blair, 1995; Jensen, 2000) and less likely to be controlled by management (Dechow, Sloan, and Sweeney, 1996; Jensen, 2000).

More recent research suggests that in the US, female board members increase the effectiveness of board monitoring and reduce the rate of financial misreporting and fraud. Furthermore, female CEOs tend to be more risk-averse, but not necessarily more ethically sensitive than male CEOs. In Asia, research examining the relationship between gender diversity on corporate boards and earnings management practices is limited but growing (Al-Sartawi, 2022).

Another factor that also affects earnings management practices is the ownership structure. It is necessary to clearly distinguish between insider ownership and government ownership in government-controlled companies (SOEs). This is because some directors may be assigned the role of government ownership representatives in these companies, namely they are nominal owners of government shares. Therefore, the total proportion of insider ownership in many companies includes both managerial shareholdings and government ownership representatives (Sun *et al.*, 2002). In theory, government shareholders may focus on the 'principle of social service assignment' rather than just on the 'interest of shareholder value' (Pham & Islam, 2022).

Many previous studies have proven that board characteristics in terms of gender diversity and the number or size of the board affect earnings management. Research conducted by (Anh & Khuong, 2022); (Ghaleb, Qaderi, Almashaqbeh, & Qasem, 2021); (Al-Absy, 2022); (Alves, 2023); (Mensah & Boachie, 2023); shows that gender diversity (female directors) has a significant negative effect on earnings management. While conflicting results were put forward by researchers (Elzahar, Zalata, & Hassaan, 2022) who stated that female directors have a significant positive relationship with earnings management. Research on the effect of the size or number of boards of directors on earnings management was conducted by (Hasan, Hossain, Rekabder, Molla, & Ashif, 2022); (Fitri & Siswantoro, 2022); (Dawleh, Lybaert, Steijvers, & Jans, 2022); (Sira, 2022); (Kolsi & Grassa, 2017). The results of the study showed that board size significantly affects earnings management. In addition, research conducted by (Nguyen, Le, & Vu, 2021); (Potharla, Bhattacharjee, & Iyer, 2021); (Wang, Liao, & An, 2022); (Boo & Lewellyn, 2017); (Tran & Dang, 2021) stated that ownership structure affects earnings management. Most of the results of the study were that government ownership had a significant effect on earnings management.

In this study, the company's financial performance is used as a moderating variable that can weaken or strengthen the influence of board characteristics and ownership structure on earnings management. With good financial performance, it is expected to minimize earnings management practices in state-owned companies. Dechow *et al.*, (2011) identified the characteristics of fraudulent companies as having high accruals, declining performance, increasing debt, and expectations of increasing stock prices. In addition, these companies also stated that the purpose of manipulation was to cover up the company's poor financial performance to maintain high stock market valuations (Franceschetti, 2017). Tabassum *et al.*, (2013) stated that there is a strong negative relationship between earnings management and company financial performance. This illustrates that managers manipulate earnings to show smooth profits and current good economic conditions, but the consequences of this activity worsen the company's performance (Tabassum, Kaleem, & Nazir, 2013). Companies with a high average board age and high ownership concentration tend to manage their earnings downward. Companies with high state ownership will reduce upward earnings management. Stakeholders should be more careful about companies with a high average board age, high ownership concentration, high financial performance, and high financial leverage because they tend to manage earnings (Nguyen Q. L., 2023).

2. Literature Review and Hypothesis

a. Agency Theory

Earnings management in agency theory can be seen when managers decide to do two activities; one in terms of productivity and the other activity results only in performance measurement but not the main utility (the activity of beautifying financial reports). The last activity can be interpreted as real or accrual earnings management. Both activities will incur costs for managers. Earnings management will also have a positive effect on managers, namely a higher level of incentives, but this will not increase the productivity of the company (Theory, 2015).

In study This, researcher use theory agency Because earnings management arises due to the existence of a wish from management to manage (increase or decrease) the company's profits. Management Companies will tend to maximize profits in order to obtain profit personal. Besides that, management also own objective for shows the owner that management's performance in managing company tend Good. Matter the arise because most Owners tend to view company performance based on profits produced by the company. Agency theory is used to explain the relationship between board characteristics and earnings management.

b. Stakeholder Theory

Stakeholder theory argues that there are stakeholders, including employees, customers, suppliers, creditors, communities, government agencies, political groups, trade associations, and unions. Even competitors are sometimes considered stakeholders. Therefore, managers as agents of shareholders must make decisions to ensure the survival and development of the business, while protecting the interests of stakeholders (Nguyen, Le, & Vu, 2021).

In study this, researcher use theory stakeholders Because earnings management arises due to the existence of a wish from stakeholders to regulate (increase or decrease) company profits. In the short term, stakeholders will tend to maximize profits in order to obtain lots of dividends. Stakeholder theory is used to explain the relationship between ownership structure and earnings management.

c. Earnings Management Theory

In study This I use formula management profit with use formula Jones Model (1991) and Dechow *et al.*, (1995) as previously conducted research. Modification Jones Model (Modified Jones) is a development of the Jones model which can detect earnings management is better than other models. Earnings management can be measured through Discretionary Accruals (DA) with method to set aside Total Accruals (TA) And Non discretionary Accruals (NDA).

Variable	Indicator	Scale
Earnings Management (Y)	$TA = NI_{it} - CFO_{it}$ $TA_{it} / Hey, t-1 = \alpha_1 (1 / Hey, t-1) + \alpha_2 (\Delta RE_{vit} / 1) + \alpha_3 (PPE_{it} / Hey, t-1) + \epsilon_{it}$ $NDA_{it} = \alpha_1 (1/A_{i, t-1}) + \alpha_2 ((\Delta RE_{vit} - \Delta RE_{Hey, t-1}) + \alpha_3 (PPE_{it} / Hey, t-1)$ $DA_{it} = (TA / Hey, t-1) - NDA_{it}$ (Tarmidi, 2019)	Ratio
Board Size (X1)	Board Size = \sum anggota dewan direksi dan dewan komisaris (Fadjarenie, 2023)	Nominal
Gender Diversity (X2)	Board Gender Diversity Percentage = $\frac{\text{Jumlah dewan perempuan}}{\text{Total anggota dewan direksi dan komisaris}}$ (Arvanitis, 2022)	Ratio
Government Ownership (X3)	Government Ownership Indicator = Percentage of share ownership held by the government (Quynh Lien Le, 2023)	Ratio
Financial performance (Z)	$ROE = \frac{\text{Profit Bersih}}{\text{Total asset}} \times 100\%$ (Quynh Lien Le, 2023)	Ratio

Several upstream studies on earnings management by Dawleh (2021), Shira (2022), Kolsi (2017), Fadjarenie (2023) show that there is a significant positive effect between the size of the board of directors on earnings management. Different results are studies by Hasan (2022), Siswanto (2022) which show that there is a significant negative effect between the size of the board of directors on earnings management. The results of research by Elzahar (2022), Hasan (2022) Mensah (2023) show that there is a significant positive effect between gender diversity and earnings management. The results of research by Tuan Anh (2022), Abdurraheem (2021), Al-Absy (2022), Alves (2023) show that there is a significant negative effect between gender diversity and earnings management. The results of research by Nguyen (2021) show that there is a significant positive effect between state ownership and earnings management. The results of research by Potharla (2021), Wang (2022), Tran (2021), Boo (2017) show that there is a significant negative effect between state ownership and earnings management.

d. Hypothesis Researcher 1 n

Based on the rarity of the research that has been compiled, the results of the study and theory Based on

the results of previous research, the hypothesis formulated by the author research 1 n because 1 ga 1 i following:

- H-1: The size of the board of directors and board of commissioners influences earnings management
- H-2: Gender diversity of the board of directors and board of commissioners has an effect on earnings management.
- H-3: Government ownership influences earnings management
- H-4: Financial performance moderates the effect of the size of the board of directors and board of commissioners on earnings management.
- H-5: Financial performance moderates the effect of board gender diversity directors and board of commissioners on earnings management
- H-6: Financial performance moderates the influence of government ownership on earnings management

3. RESEARCH METHODOLOGY

The Population in this research is state - owned enterprises listed on the Indonesian Stock Exchange (BEI) in 2018–2022. The method used this research is a sample method using a purposive sample technique.

Sample Selection Process

No.	Sample Selection Process	Total Sample
1.	Number of SOEs listed on the IDX consecutively from 2018-2022	14
2.	Number of SOEs that did not experience consecutive profits from 2018-2022	(3)
Total number of SOEs used as samples		11
Total research data during 2018-2022 (5 years)		55

Data Analysis Methods

Chow test

The chow test is used to select one of the best models in panel data regression between *the Common Effect Model (CEM)* and *the Fixed Effect Model (FEM)*. The hypothesis in the chow test is:

- a) H0: Common Effect Model
- b) H1: Fixed Effect Model

The guidelines used in drawing chow test conclusions are as follows:

- a) If the *Cross-section Chi-square Prob* is < ($\alpha=0.05$), then H0 is rejected; the fixed effect model is selected.
- b) If the *Cross-section Chi-square Prob* has a value of > ($\alpha=0.05$), then H0 is accepted; the common effect model is selected.

Hausman test

The Hausman test is used to choose between the *Random Effect Model (REM)* and the fixed effect model. The hypothesis in the Hausman test is:

- a) H0: *Random Effect Model*
- b) H1: *Fixed Effect Model*

The guidelines used in drawing conclusions from the Hausman test are as follows:

- a) If the *Cross-section Random Prob* is $< (\alpha= 0.05)$, H0 is rejected; *the fixed effect model* is selected.
- b) If the *Cross-section Random Prob* has a value of $> (\alpha= 0.05)$, H0 is accepted; the *random effect model* is selected.

Lagrange Multiplier Test

The Lagrange Multiplier test is used to compare or select the best model between the *Common Effect*

Model (CEM) and the *Random Effect Model (REM)*. The statistical hypotheses in the test are:

- a) H0: *Common Effect Model*
- b) H1: *Random Effect Model*

The LM test calculation method used in this study is the Breusch-Pagan method. The Breusch-Pagan method is the method most widely used by researchers in calculating the LM test. The guidelines used in drawing conclusions from the LM test based on the Breusch Pagan method are as follows:

- a) If the Breusch-Paga *Cross -section* value is $< (\alpha= 0.05)$, H0 is rejected; the random effect model is selected.
- b) If the Breusch-Pagan *Cross-section* value $> (\alpha= 0.05)$, H0 is accepted; the common effect model is selected.

4. RESULTS AND DISCUSSION

t-Test Results		
Variables	t - Static	Prob
Board Size (X1)	-3.702810	0.0008
Gender Diversity (X2)	6.187096	0.0000
Government Ownership (X3)	-8.165976	0.0000
Financial Performance (Z) * Board Size (X1)	1.485975	0.1468
Financial Performance (Z) * Gender Diversity (X2)	-5.640676	0.0000
Financial Performance (Z) * Government Ownership (X3)	6.875728	0.0000

Source: Data processed through EVIEWS 12, 2024

The results of the first hypothesis test show that board size has a significant negative effect on earnings management. The greater the number of board members and board members in a company, the smaller the practice of earnings management in the company. Board size in agency theory shows that large financial institutions require a large number of board members and board members to increase expertise, resources, and customer and depositor networks. The greater the number of board members, the stronger the company.

The results of the second hypothesis test indicate that the gender diversity variable has a significant positive effect on earnings management. The results of the direction of influence between gender diversity and earnings management in this study are positive, which means that the more gender diversity in the positions of the board of directors and board of commissioners, the greater the practice of earnings management in the company. According to Amason (1996), women are less sensitive to group thinking and women tend to provide new ideas because women are not included in the network of "old people".

The results of the third hypothesis test show that the government ownership variable has a significant negative effect on earnings management. The direction of the influence is negative, which means that the greater the portion of government ownership in a company, the more it will minimize the practice of earnings

management in it. The performance of State-Owned Enterprises (ISOE) is not only supervised by shareholders but also by the public so that performance both operationally and financially will always be maintained. A larger portion of government ownership in ISOE shares will make ISOEs careful in manipulating profits. This is reinforced by research from (Zhihao Wang, 2023).

The results of the fourth hypothesis test indicate that financial performance is unable to moderate the relationship between board size and earnings management. Using board size as a measure of board characteristics, many studies have shown that a large board of directors can provide more time and effort to exercise control and increase the transparency of accounting reports, therefore limiting.

The results of the fifth hypothesis test show that financial performance is able to moderate the relationship between gender diversity and earnings management. Corporate governance illustrates that women are more ethical in their judgment and behavior. Thus, they are less likely to engage in unethical behavior, thereby effectively reducing managerial opportunism (Zalata et al., 2019). Female directors are ethical and risk-averse in financial decision making (Doan & Iskandar-Datta, 2020; Ismail et al., 2020), also explaining that female directors are less aggressive in making investment and acquisition decisions, resulting

in higher financial performance. Therefore, there is a greater possibility that women on the board will refrain from unethical practices such as *earnings management* (Githaiga, Kabete, & Bonareri, 2022).

The results of the sixth hypothesis test show that financial performance is able to moderate the relationship between government ownership and earnings management. Large ownership will create high earnings management practices with the aim of a large rate of return for the owner. The company's financial performance will moderate the influence between ownership structure and earnings management. This means that based on stakeholder theory, maximizing the company's financial performance and conducting earnings management will increase stakeholder or owner satisfaction with the company.

5. CONCLUSION AND SUGGESTIONS

CONCLUSION

Board size has a significant negative effect on earnings management. Gender diversity has a significant positive effect on earnings management. Government ownership has a significant negative effect on earnings management. Financial performance is unable to moderate board size on earnings management. Financial performance is able to moderate gender diversity on earnings management. Financial performance is able to moderate government ownership on earnings management.

SUGGESTION

Based on the conclusions that have been explained, the following suggestions can be made for this research:

1. Advice is given to companies to always pay attention to the policies made, especially related to legal profit management policies so that the level of public trust in the company will increase. Companies are also expected to consider the size of the board of directors and board of commissioners, gender diversity of the board of directors and board of commissioners, and government ownership to avoid prohibited profit management actions.
2. Suggestions are given to further researchers to use different samples from this study so that the results of further research will explain earnings management more broadly from different corporate sectors. Suggestions are given to further researchers to use different variables from this study so that the results of further research will explain the factors that influence earnings management more broadly.
3. Advice was given to the government to continue to be involved in companies by having a portion of share ownership in each company so that all company policies will be in accordance with applicable provisions.

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