THE INFLUENCES OF CORPORATE GOVERNANCE AND AUDIT QUALITY ON EARNINGS MANAGEMENT: STUDY ON INDONESIAN PUBLIC BANKS

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ABSTRACT
The practices of earnings management are carried out by management due to their opportunistic behavior to achieve certain goals. In mitigating credit risk, a bank is required to set aside a specific amount of funds to cover the expected losses which referred to Loan Loss Provision (LLP). It is one of the largest accruals for a bank because of its important role which connected with the main operating activity in all commercial banks that reflect the quality of earnings assets. LLP can be manipulated by management using smoothing income in order to make earnings looked relatively stable. This research aims to examine the influences of corporate governance, audit quality and company size as control variable on earnings management proxied by discretionary loan loss provisions. This research uses a population of public banks listed in Indonesia Stock Exchange (IDX) on period 2014-2018. The number of sample in this study gathered using purposive sampling method were 26 companies. Statistical analysis method used in this research is multiple linear regressions. The results indicate that institutional ownership had a negative and significant effect on earnings management, while independent board of commissioners, audit committee and audit quality had no significant effect on earnings management.

Keywords: earnings management, discretionary loan loss provision, corporate governance, audit quality, company size

INTRODUCTION
The issue of earnings management has became problems all over the world and shown by financial companies managing their income, especially banks that manage their income to comply with regulatory requirements for banking activities. In Indonesia the development of the banking sector is rapid, marked by the presence of several local banks that can compete with other large banks in Southeast Asia (ASEAN) level. According to the kompas.com (April 26th, 2019), three Indonesian banks including BCA, BRI and Mandiri are in the top 10 largest banks with the largest capitalization in Southeast Asia. The success of several local banks in the Southeast Asia level shows that the performance of banking operations in Indonesia is considered getting better. Along with the increasing operational performance of financial firms, especially in the banking sector can lead to higher competition.
The business competition is characterized by the rapid development of the current economy which required every company to perform good strategic planning to achieve the company goals. This condition encourages the manager to manipulate earnings by increasing the performance of the company to show that their company has good conditions and better prospects in the future. Greenwalt and Sinkey in Ozili and Outa (2017) explained that banks engage in earnings management practices by smoothing their reported earnings to make the reported earnings stable overtime to meet some defined prudential regulatory objectives or opportunistic financial reporting objectives. In the banking sector, the practice of income smoothing can be practiced through loan loss provisions which are considered as an important tool used by bank to smoothen the income due to its direct impact on bank net interest margin and its role in mitigating credit risk arising from bank lending (Ozili, 2019). For most banks, loans represent one of the largest assets, and as a result, the Loan Loss Provision (LLP) is one the largest accruals (Kwak et al., 2009).

The main activity of banks is to collect deposits and issue loans to individuals, firms, and governments to finance consumption, investment and capital expenditure which will contributing to economic growth. Bank lending to borrowers often gives rise to credit risk if borrowers are unable to repay the principal and interest on the loan facility due to unfavourable economic conditions and related factors. To reduce the credit risk, the bank is required to set aside a specific amount of funds to cover the expected losses on the bank which this amount is referred to as Loan Loss Provisions (LLP). LLP is important for the health and stability of the banks, which is a significant accrual in all commercial banks.

Generally, LLP can be used by banks to overcome and manage problems concerning losses from loan activities, meet regulations or laws on the capital requirement and manage present and future income. However, LLP can be manipulated by the manager to pursue other managerial objectives such as income smoothing in banks. The ability to manipulate LLP derives mainly from the existence of judgemental components of provisioning related to the identification of impaired assets and the overall assessment of possible future credit losses. Banks may increase LLP when earnings are high and decrease them when earnings are low, to present fairly constant profits overtime, reducing the perception of default profitability, stabilizing compensation of managers and granting a steady flow of dividends to bank stockholders (Aristei and Gallo, 2019). Managers can use LLP to smooth income down by increasing provisions and vice versa, managers can delay or make loan losses to smooth income up. Kanagaretnam et al. (2004) provided consistent evidence that DLLP is used by bank managers to reduce earnings variability or smooth income and evidence indicating that managers use it to gain and loss securities sales as substitutes for DLLP when managing earnings. Hence, the managers of banks tend to have large incentives to managing financial statements by smoothing the value of LLP.

The company need a system that is able to minimize the occurrence of earnings management practices and improve the quality of financial statements, namely, Corporate Governance. The concept of corporate governance is expected to create more
transparent corporate management for all users of financial statements. Gompers et al. in Man and Wong (2013) argued that corporate governance would reduce the agency problem between financial providers and managers and increase the efficiency of contracts. Corporate governance is carried out through supervising or monitoring the performance of management as an effort to ensure the manager of the company always takes appropriate and selfless actions in the decision-making process. The implication of corporate governance mechanisms in the company can be done through the existence of the Independent Board of Commissioners, Audit Committee, Institutional Ownership, and External Auditor.

Based on the agency theory, the board of the company formed of outsider commissioners is more effective than insider commissioners and the best solution to enhance internal control inside of the company. Since outsiders are independent of management, they can effectively control the actions of managers, and they can act independently and objectively in their supervision process (Fama & Jensen, 1983). In addition, Beasley (1996) suggested that Independent Board independence is a better method of oversight of management in preventing financial statement fraud and therefore limiting earnings management practices.

An audit committee is said to be efficient if it has the skills enabling it to perform the supervision of internal audit and control, external audit and financial statements (Kalbers and Fogarty in Zgarni et al., 2018). The existence of an audit committee on the board also enhances the quality of financial statements by reducing agency problems between managers and shareholders (Klein, 2002). The audit committee is also important in the company due to its monitoring role in the supervision of management actions and the controlling of discretionary behavior (Beasley, 1996).

Other corporate governance that able to resolve the conflict between the owners and the managers are institutional ownership which is the ownership of the company by the other interested parties. Jensen and Meckling (1976) argued that there is one way to reduce agency costs and it is to increase the institutional ownership that aims to oversee the agents. The company has the ability to survive if there is a separation between the owner and the management. A company that has greater institutional ownership can monitor the company closely, to encourage management to carry out company activities more transparently, including disclosures as a form of information and accountability to shareholders.

All public companies in Indonesia must have their annual financial statements audited by an independent and accredited public accountant that is registered in OJK. Based on the agency theory, an external auditor reduces the information asymmetry between the principal and the agent and minimizes conflicts of interest (Watss and Zimmerman, 1983). The audit quality can be interpreted as good or not through an examination carried out by the auditor. The audit quality is related to how well an audit is completed compared to the predetermined criteria wherein carrying out their duties; the auditor is guided by accounting standards and the relevant code of ethics of public accountants. Audit quality can be measured using the Public Accounting Firm which is included in Big Four Companies and Non-Big Four.
In Indonesia, the classification of company size is divided into four categories, namely micro, small, medium, and large companies (The Law of Republic of Indonesia number 20 year 2008). Sulistyanto (2008:208) argued that the large companies will be more considered by the outsiders than smaller companies where the manager of large companies tend to have the motivation to be involved in earnings management and prefer to prioritize the interests of shareholders. Besides, large companies have a more effective internal control system and corporate governance than the small companies, which leads to the reliability of its financial statements to the public (Warfield et al., 1995). The larger banks are the most likely to be monitored by industry analysts. As a consequence, they will be less incited to artificially increase income using discretionary accruals (Cornett et al., 2009). Based on the explanation above, the author is interested in discussing the factors that affect discretionary accruals in the financial institutions, especially public banks in Indonesia.

LITERATURE REVIEW

Agency Theory

The agency theory is the relationship or between principals and agents, Jensen and Meckling (1976) defined the agency theory as a contract under, which one or more principals engage another person (agent) to perform some services on their behalf which involves delegation some decision-making authority to the agent. The principal employs the agents to carry out business in the interest of principals, including delegation of authorization for decision making from principals to agents (Anthony and Govindarajan, 2005).

The different interests between agent and principals are often leads to problems or conflicts that are referred to as the agency problem. According to Rankin et al. (2012:280), the agency problem relates to the difficulties or problems in motivating the agent to work in the best interests of the principal, where the problem arises because of inefficiencies and incomplete information. The agency problem arises mainly because the principals cannot monitor the daily activities of the agents and ensure that they work under the interests of shareholders. The principals do not have enough information about the performance of the agents, while the agents have more information about their capacity, work environment and the whole company. This condition leads to imbalance information due to the managers having more information about the current and future prospects of the company than an outsider (Rankin et al.,2012:281). The information asymmetry and conflicts of interest between the principals and agents provide an opportunity for managers to maximize their interests, one of which is to conduct earnings management in present information that is not true to the principal, especially if the information is related to the performance measurements of the manager.

Earnings Management

Earnings management occurs when the managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers (Healy and Wahlen, 1999). The practice of earnings management is carried out by
management to maximize the benefits of management so that they can affect the investors in the investment process. Besides that, the earnings management also arises because various accounting methods are recognized and accepted in accounting standards and generally accepted in accounting principles (Sulistyanto, 2008:103). The flexibility of management to choose the various accounting policies give opportunities for efficient and opportunistic contracting behaviour, which means the rational managers will choose the accounting policies that can maximize their expected utility and the company market value. The practice of earnings management by the companies causes biased financial statements which can reduce the quality and credibility of the financial statements and also reduce the investor trust in the reliability of financial information issued by the company. The main motive for earnings management practices is to mislead the users of financial information and to influence the contracts that will be generated by the company.

**Loan Loss Provision**

The bank is required to set aside a specific amount of funds to cover the expected losses on the bank in reducing credit risk which this amount is referred to as Loan Loss Provisions (LLP) or the impairment of financial assets. According to BI Regulation Number 14/15/PBI/2012 regarding the assessment of commercial bank asset quality, the LLP is a reserve established in case the recorded value of financial assets shall be less than the originally recorded value after impairment. Wahlen in Lassoued et al. (2018) explained that to measure earnings management in banks, LLP is split into discretionary and non-discretionary (NDLLP) components. DLLP refers to the component of LLP that is subject to the manipulation of bank managers, given underlying earnings management motives and induced by managerial discretion. NDLLP represents information related to the default risk and bad debts, which cannot be controlled by bank managers which report the portion of total accruals because of changes in bank business conditions.

The LLP reflects the quality of earnings assets. The higher the LLP means that the lower the quality of earnings assets in the bank. Bank Indonesia requires commercial banks to make the allowance for impairment losses on financial assets. The minimum allowance should be provided based on BI regulation. According to the Accounting Guidelines of Indonesia Banking (PAPI) (2008:186), the bank can use various techniques to evaluate and measure the LLP both individually and collectively by considering the costs, the benefits and the availability of the information and historical data. The following are several techniques to measure LLP values under PAPI:

1) Individual, using the method of discounted cash flow and the fair value of collateral,

2) Collective, using estimated future contractual cash flows of collective group loans and historical loss rate or historical net charge-off rate of collective group loans.

**Corporate Governance**

According to the Indonesia CG Manual(2018:27), corporate governance is a set of relationship between a company’s management, its board, its shareholders and other stakeholders which also provide the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Gompers et al. in Man
and Wong (2013) argued that corporate governance would reduce the agency problem between financial providers and managers, and increase the efficiency of contracts. In other words, corporate governance is also an effective mechanism that can be used to reduce the occurrence of earnings management in the company. With the implementation of good corporate governance in the company, it can encourage the formation of clean, transparent, and professional management work patterns and minimize the risk of earnings management in the company.

**Independent Board of Commissioners**

Based on BI Regulation Number 8/4/PBI/2006 Article 1(4) concerning the Implementation of GCG for Commercial Banks, Independent commissioners are members of boards of commissioners who have no financial, management, share ownership and/or family relationships with other members of the board of commissioners, directors and/or controlling shareholder or other relationship that may affect his ability to act independently. Independent Commissioners can make a substantial contribution decision of the company, especially in evaluating executive and commissioner remuneration, reviewing financial statements, and resolving corporate conflicts. They give investors additional confidence that the Board of Commissioner’s deliberations will be free of oblivious bias.

**Audit Committee**

Audit committee is a committee established by and responsible to the Board of Commissioners to help perform the duties and functions of the Board of Commissioners (OJK Regulation Number 55/POJK.04/2015). Audit committee plays a critical role in assisting the Board of Commissioners to discharge its oversight responsibility for adequate and effective risk management, financial reporting, control, governances, internal and external audit. Issuers, public companies, and listed companies in Indonesia must establish an audit committee. The existence of the audit committee is also to assist the Commissioners in monitoring and evaluating the audit planning and implementations as well as monitoring the audit result follow up actions to assess the adequacy of internal audit including the adequacy of the financial reporting process.

**Institutional Ownership**

Institutional ownership is defined as the number of shares owned by other institutions or other companies. Jensen and Meckling (1976) argued that one way to reduce agency costs is to increase the institutional ownership that aims to oversee the agents. The company can survive if there is a separation between the owner and the management and the decision making is not based on the largest shareholders. The percentage of certain shares owned by an institution may affect the process of preparing the financial statements where there is a possibility of actualization following the interests of management (Gideon in Ujiyantho and Pramuka, 2007).

**Audit Quality**

An independent audit committee by external auditors is an important element of the company control framework. Indonesia CG Manual (2018:260) suggested the role of the external auditors is to express an opinion on whether of the financial statement of the company is prepared
under an identified financial reporting framework and whether they are reliable. The Big Four auditors are considered more qualified because the auditors are competent with a series of training and procedures and have several audit programs that are more accurate and effective than auditors from non-Big Four auditors. The large auditors are more independent and tend to provide a higher quality of audit (De Angelo, 1981).

**Company Size**

The company is an organization established by an individual or group of people or other bodies whose activities are to perform production and distribution to meet the needs of the human economy. Wuryani (2012) stated that the company size is related to the number of resources owned by the company which can be represented by total assets, number of sales, average sales, and average total assets. The size of the company is one of the indicators used by investors in assessing the performance of the company. The large companies have more effective internal control system and qualified and competent team rather than smaller companies. Companies with larger assets tend to maintain their reputation and credibility by avoiding earnings management. The larger banks are the most likely to be monitored by industry analysts.

**Hypotheses:**

H$_1$: Independent Board of Commissioners negatively affects earnings management
H$_2$: Audit Committee negatively affects earnings management
H$_3$: Institutional Ownership negatively affects earnings management
H$_4$: Audit Quality negatively affects earnings management

**RESEARCH METHODOLOGY**

This research is quantitative research. The population of this research is public banking companies listed in Indonesia Stock Exchange (IDX). The samples used in this research are done by a purposive sampling method that is the determination of sample based on suitability of certain characteristics and criteria that are set for specific purposes (Sugiyono, 2016:85). The sampling characteristics are as follows:

1. The public bank listed in Indonesia Stock Exchange (IDX) 2014-2018,
2. The public bank that publish annual financial statements for the period of 2014-2018 which have been audited,
3. The public bank that show profits in the financial statements for the period 2014-2018,
4. The public bank that has completed data related to all variables for the period 2014-2018.

**DEPENDENT VARIABLE**

**Earnings Management (DLLP)**

The dependent variable in this research is earnings management measured using discretionary accrual proxies. The first research that suggests the specific accruals as the best proxy to detect earnings management in specific industries such as banks and insurance companies is Mchnicas and Wilson (1988). Furthermore, LLP as the main variable representing the specific accruals earnings management of banks have been used by some researchers including Taktak and Mbarki (2014); Othman and Mersni (2016); Kolsi and Grassa (2017); Zgarni et al. (2018); Lassoued et al. (2018); Saiful and Dhah (2018). LLP proxy is divided into two components: Discretionary and Non-Discretionary. Hence, the basic model takes the form:
LLP = Non-Discretionary LLP (NDLLP) + Discretionary LLP (DLLP)

The non-discretionary component of LLP represents the portion of total accruals dictated by changes in bank business conditions. Since it cannot be directly observed, it is estimated through variables reflecting the level of losses in the loan portfolio. This research follows the same approach of Othman and Mersni (2014) and Zgarni et al. (2018) which estimate the DLLP and NDLLP with the following steps:

1) Estimation of the regression’s parameters

\[
LLP_{it} = \beta_0 + \beta_1 NPL_{it-1}/TL_{it-1} + \beta_2 \Delta NPL_{it}/TL_{it-1} + \beta_3 \Delta TL_{it}/TL_{it-1} + \epsilon_{it} (1)
\]

where:

\( LLP_{it} \): Total loan loss provision for banks i at the year t divided by total loans of year t-1

\( NPL_{it-1} \): The beginning balance of non-performing loan for bank i at the year t divided by total loans of year t-1

\( \Delta NPL_{it} \): Change in the value of the non-performing loan for bank i at the year t divided by total loans of year t-1

\( \Delta TL_{it} \): Change in the value of total loans for bank i at the year t divided by total loans of year t-1

\( \epsilon_{it} \): The residual of the equation which represents discretionary provisions of bank i in year t

2) Estimation of the non-discretionary component of loan loss provisions.

The estimated coefficients \( \hat{\beta}_1, \hat{\beta}_2, \) and \( \hat{\beta}_3 \) of regression (1) are used to calculate the predicted value of non-discretionary LLP (NDLLP). This component is calculated using the following equation:

\[
NDLLP_{it} = \hat{\beta}_0 + \hat{\beta}_1 NPL_{it-1} + \hat{\beta}_2 \Delta NPL_{it} + \hat{\beta}_3 \Delta TL_{it} (2)
\]

3) Estimation of the discretionary component of loan loss provisions.

Finally, the last step is to obtain the Discretionary Loan Loss Provisions (DLLP) by calculating the difference between total loan loss provisions and estimated non-discretionary LLP, the equation becomes:

\[
DLLP_{it} = LLP_{it} - NDLLP_{it}
\]

\[
DLLP_{it} = LLP_{it} - (\hat{\beta}_0 + \hat{\beta}_1 NPL_{it-1} + \hat{\beta}_2 \Delta NPL_{it} + \hat{\beta}_3 \Delta TL_{it}) (3)
\]

**INDEPENDENT VARIABLES**

**Independent Board of Commissioners**

Independent commissioners should make up at least 30% of BoC of a listed company in Indonesia (OJK Regulation No.33/POJK.04/2014). The proportion of IBC is calculated by dividing the number of Independent Board of Commissioners with the total membership of the Board of Commissioners, presented with the following equation:

\[
Proportion\ of\ IBC = \frac{The\ Number\ of\ IBC}{Total\ Member\ of\ BoC} \times 100\%
\]

**Audit Committee**

The Audit Committee should consist of at least three members, comprising independent commissioners as well as parties from outside the company (ICG Manual, 2018: 173). According to Fitri et al. (2018), this variable is calculated by the total members of the Audit Committee in the company.
Institutional Ownership

The ownership of shares that are more concentrated in the institutions makes the institution become a majority shareholder which causes them to have a large influence on the company so that they have incentives that are greater for managing the company properly. The institutional ownership is measured by the following equation (Wirayana and Sudana, 2018):

\[
IO = \frac{\text{Shares owned by institutional investors}}{\text{Total of outstanding shares}} \times 100\% 
\]

This research using dummy variable to grouping the institutional ownership into four categories which is a value of 1 if the percentages of institutional ownership between 76% until 100%, a value of 2 if the percentages of IO is 51% until 75%, a value of 2 if the percentages of IO between 26% until 50% and value of 4 if the percentages of IO between 0% until 25%.

Audit Quality

The audit quality in this research is defined as the size of the Certified Public Accounting Firm. This variable is measured using a dummy variable. If the company is audited by a large Public Accounting Firm (Big Four), then audit quality is high, and if audited by Public Accounting Firm (Non-Big Four), then audit quality is low. Audit quality in this research is measured by non-metric (ordinal) data, with a value of 0 if company is audited by Big Four and 1 if audited by Non-Big Four.

CONTROL VARIABLES

Company Size

The company size is one indicator used by the investor in assessing company assets and performance. The large companies are given more attention by the public so that the management of the company will be more careful in reporting the financial statements that lead to more accurate financial report conditions. The larger the size of the company, the easier it is to access the company information and its availability to the investors, especially regarding the decision making of the investment. The company size is calculated by using this formula (Kolsi and Grassa, 2018):

\[
\text{Company Size} = \text{Natural log (Total Assets)} 
\]

DATA METHOD ANALYSIS

The data analysis method used in this research is multiple linear regressions analysis. The regression processed using the computerized calculation of Statistical Package for Social Science (SPSS) version 23.0, which is a computer program to analyze data and perform statistical calculations such as descriptive statistics, the classical assumption test, hypothesis test using t-test and the coefficient of determination (R^2).

RESULTS AND DISCUSSIONS

Table 1. Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>DLLP</td>
<td>130</td>
<td>-0.25</td>
<td>0.03</td>
<td>0.00</td>
<td>0.01</td>
</tr>
<tr>
<td>IBC</td>
<td>130</td>
<td>0.40</td>
<td>0.80</td>
<td>0.57</td>
<td>0.94</td>
</tr>
<tr>
<td>AC</td>
<td>130</td>
<td>3.00</td>
<td>8.00</td>
<td>3.98</td>
<td>1.14</td>
</tr>
<tr>
<td>IO</td>
<td>130</td>
<td>1.00</td>
<td>4.00</td>
<td>1.77</td>
<td>0.76</td>
</tr>
<tr>
<td>BIG4</td>
<td>130</td>
<td>0.00</td>
<td>1.00</td>
<td>0.22</td>
<td>0.42</td>
</tr>
<tr>
<td>SIZE</td>
<td>130</td>
<td>28.30</td>
<td>34.80</td>
<td>31.71</td>
<td>1.63</td>
</tr>
</tbody>
</table>

Multiple Linear Regressions

This analysis is used to determine whether each independent variable is positively or negatively related and predicted the value of the dependent variable when the value of the independent variable has increased or decreased. This research examined the effect of the proportion of independent commissioners (X_1), audit committee size (X_2), institutional ownership (X_3),
and audit quality ($X_4$) as independent variables and company size ($X_5$) as control variable to the earnings management (DLLP) as the dependent variables ($Y$).

Table 2. Multiple Linear Regressions

<table>
<thead>
<tr>
<th>Variable</th>
<th>$\beta$</th>
<th>t-value</th>
<th>Sig.</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBC</td>
<td>0.026</td>
<td>0.363</td>
<td>0.717</td>
<td>Not Significant</td>
</tr>
<tr>
<td>AC</td>
<td>-0.040</td>
<td>-0.552</td>
<td>0.582</td>
<td>Not Significant</td>
</tr>
<tr>
<td>IO</td>
<td>-0.234</td>
<td>-3.298</td>
<td>0.001</td>
<td>Negative Significant</td>
</tr>
<tr>
<td>BIG4</td>
<td>-0.028</td>
<td>-0.381</td>
<td>0.704</td>
<td>Not Significant</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.708</td>
<td>8.424</td>
<td>0.000</td>
<td>Control Variable</td>
</tr>
</tbody>
</table>

Based on the table 2, the form of the multiple linear regression equation can be formulated as follows:

1) The regression coefficient of IBC is positive, which is 0.026, which means that an increase value of IBC by 1 will increase DLLP by 0.026. It means that IBC has positive effect on earnings management (DLLP).

2) The regression coefficient of AC is negative, that is -0.040, which means that an increase in the value of AC by 1 point will decrease DLLP by 0.040. Thus, it can be concluded that AC has negative effect on EM.

3) The regression coefficient of IO is -0.234, which means that an increase in IO value by 1 point will decrease DLLP. Consequently, it can be concluded that IO has negative effect on earnings management (DLLP).

4) The regression coefficient of BIG4 is negative, which is -0.028. It shows if companies that audited by Big Four, then earnings management (DLLP) will decrease by 0.028 point. Thus, the audit quality (BIG4) has negative effect on earnings management.

5) As control variable, the regression coefficient value of SIZE is positive, which is 0.708 which means that an increase of SIZE value by 1 point will increase DLLP by 0.708. The company size has positive effect on earnings management.

Coefficient of Determination ($R^2$)

The coefficient of determination is used to measure how much the independent variable and control variable used in this research contributed or influenced the dependent variable which is Discretionary Loan Loss Provisions (DLLP). Based on table 2, the coefficient of determination ($R^2$) is 0.440 which means that 44% of the dependent variable (DLLP) is influenced by the independent variables and control variable (IBC, AC, IO, BIG4, SIZE). Meanwhile, the rest of 56% of the dependent variable is influenced by another independent variable, which is not discussed in this research.

HYPOTHESES TESTING

The purpose of hypothesis testing is to answer the hypotheses that have been constructed above. These can be checked through a statistical measurement called t-test to find out whether the independent variable regression model has a significant effect on the dependent variable partially by comparing the t-value and t-table at a significant level $\alpha=5\%$. The assessment is that $H_0$ is rejected, and $H_a$ is accepted if $t$-value > $t$-table. The hypothesis testing is also done by calculating the p-value of each independent variable by comparing the p-value with the degree of error ($\alpha$) 5%. The testing criteria is $H_0$ is rejected, and $H_a$ is accepted if the p-value < 5%, which means that the independent variable significantly affects the dependent variable.
Based on the table above, the t-value of IBC is 0.363, while t-table is 1.656. Since t-value is lower than t-table which is 0.363 < 1.656 or p-value is 0.3585 from sig. (0.717/2) > α = 0.05, it means that the influence of independent board of commissioners (IBC) on earnings management (DLLP) is not significant. Thus, the hypothesis 1 which is state that independent board of commissioner negatively affects earnings management is rejected.

The t-value of AC is -0.552 then the t-value is smaller than t-table which is -0.552 < 1.656 or p-value is 0.291 from sig. (0.582/2) > α = 0.05, meaning that the influence of audit committee (AC) on earnings management is not significant. Thus, the hypothesis 2 which is state that audit committee negatively affects earnings management is rejected.

According to table 3, the t-value of IO is -3.298 then the t-value < t-table which is -3.298 < 1.656 or p-value is 0.0005 from sig.t (0.001/2) < α = 0.05, it means that the influence of institutional ownership (IO) on earnings management (DLLP) is significant. Hence, the hypothesis 3 which is state that institutional ownership negatively affects earnings management is accepted. The t-value of BIG4 is -0.381. Since the t-value is < t-table which is -0.381 < 1.656 or p-value is 0.449 from sig.t (0.898/2) > α = 0.05, it means that the influence of audit quality (BIG4) on earnings management (DLLP) is not significant. Therefore, the hypothesis 4 which is state that audit quality negatively affects earnings management is rejected. The control variables of company size are significant determinants of the discretionary provisions which means it is important covariates that must be included in the model given that its significant influences on dependent variables.

DISCUSSIONS
The Influences of Independent Board of Commissioners on Earnings Management
According to the results of hypotheses testing which means that Independent board of commissioners have not been able to work effectively to improve the supervision of management in reducing earnings manipulation in Indonesian public banks. The results of this research indicate that the larger the proportion of independent commissioners in the company does not affect discretionary behavior of managers. It is because the greater the independent commissioners will cause a decline in supervisory functions and can disrupt them in decision-making. This research is in contrast with prior research such as research conducted by Fama and Jensen (1983), Beasley (1996), Xie et al. (2003), Kolsi and Grassa (2017), Mbarki and Taktak (2014), and agency theory that argued the board of a company formed by outsider commissioners is more effective than a company that consists of insider commissioners and best solution to enhance the internal control.

Fulfilment of independent commissioners conducted by public banks is only to fulfil the regulations governing the proportion of the board of commissioners in each bank (Ujiyantho and Pramuka, 2007). The research shows the averages of independent boards of commissioners.
commissioners in Indonesian public banks is 58% which have appropriate with BI Regulation No.8/4/PBI/2006 Article 5(2) with approximately 50% of commissioners of a listed company should be independent. Thus, the independent commissioners are not able to work optimally to prevent earnings management practices under their functions as supervisor and advisors in the company.

Based on agency theory, the results support the previous study by Saiful and Dyah (2018) who found that board independence is ineffective to reduce earnings management due to there is a tendency that the position of directors is usually very strong, even there are directors who are reluctant to share authority and do not provide adequate information to independent commissioners. This condition can be caused by the difficulty of coordination between the members of the board and this hampers the supervision process, which should be the responsibility of the BoC. Regardless of the proportion of IBC in the company, it does not affect the behavior of managers in earnings management practices because of the information asymmetry arise where the management is better informed about company information compared to the board of commissioners who speak more about control issues and company policies (Fitri et al., 2018). It is indicates that this research is support the agency theory where the managers have such excessive power over firm resources so that in some cases, they could undermine the control executed by the independent commissioner members.

The Influences of Audit Committee on Earnings Management

Based on the statistical result, this study indicates that the existence of audit committee in the public banks was not able to reduce earnings management. This is due to an inefficiency of audit committee size in auditing financial statements and protects the interest of shareholders from the practices of earnings management. The result of this research is in line with research conducted by Xie et al. (2003), Saiful and Dyah (2018), Kolsi and Grassa (2017), and Zgarni et al. (2018).

This research is in contrast with prior research such as research conducted by Klein (2002) and Othman and Mersni (2016), which argued that an audit committee plays an important monitoring role in the corporate governance structure of the company that improves accounting information quality which is effective to limit the discretionary behavior of managers. The results are support the agency theory where the larger size of audit committee give rise to conflict of interest in the company. The large size of audit committee can trigger conflicts so that they lose their focus and become less participative than smaller size (Pincus in Zgarni et al., 2018). The management will take advantage of audit committee size to achieve their own benefits where they will reduce audit committee involvement by increasing its size.

The result of this research can be explained by the decision-making theory (Zgarni et al., 2018). This theory indicates that board or committee size may slow down the decision-making process, thereby giving additional discretion to managers who manage earnings in the desired direction. Hence, the decision-making process in company would be more effective with a small committee size. In additional, Indonesian public banks are required to have audit committee that consist of at
least three members including one independent commissioner, one external party with expertise in finance or accounting and one external party with expertise in law or banking (Indonesia CG Manual, 2018). However, this research showed that is only 45% from 26 public banks in Indonesia have the minimum number of audits committee proportions with finance and banking backgrounds under the CG regulation, while the other banks have exceeded the minimum limit of audit committee size. Based on the weaknesses of audit committee in big size in the previous paragraph, therefore they are not effective to evaluate the performance of the company management and internal auditors in reducing earnings management.

The Influences of Institutional Ownership on Earnings Management

Based on the statistical result, this research shows a significant causal relationship between institutional ownership (IO) and earnings management proxied by discretionary loan loss provisions (DLLP). Therefore, the third hypothesis stated that institutional ownership negatively affects earnings management is accepted. It indicates that the higher institutional ownership in the public banks means the lower opportunity of the manager to manipulate earnings. This research is in contrast with previous research conducted by Lassoued et al. (2018), Kolsi and Grassa (2017), and also Wirayana and Sudana (2018) which confirmed the theory of entrenchment where the majority of shareholders have control rights that can be used to encourage the manager to take opportunistic actions in their interests of majority shareholders.

Based on agency theory, this research results show that institutional ownership is able to solve the agency problem arises in Indonesia which is a little separation of ownership and control. Institutional ownership proven as effective corporate governance in reduces weakness of accountability and capital structure, poor information disclosure in the company. This research is in the same line with efficient monitoring hypothesis by Roychowdury (2006) where the institutional investors are more aware and well-informed than other shareholders because of their expertise, professionalism, and resources are all allowing them to optimize their monitoring. A company that has greater institutional ownership can be monitored more closely, so it encourages the management to run the company activities more transparently, including in terms of disclosure as the delivery of the information and the accountability to shareholders. Therefore, large institutional ownership may have incentives to limit managerial use of earnings management. This research supports the idea that the presence of institutional ownership improves the efficiency of governance as they have better access to information and greater expertise in achieving performance (Jensen, 1993). The result of this research indicates that institutional ownership is an effective mechanism of corporate governance in preventing the number of earnings management practices on Indonesian public banks.

The Influences of Audit Quality on Earnings Management

The fourth hypothesis is rejected which means that the companies audited by Big Four public accountant companies indicate greater earnings management compared to companies audited by Non-Big Four. This research
indicates neither Big Four nor Non Big-Four companies can be proved to significantly detect the earnings management through the audit of the financial reporting they conducted. This research is inconsistent with the agency theory, which is an external auditor reduces the information asymmetry between the principal and the agent and minimizes conflicts of interest (Watts and Zimmerman, 1983).

The result of this research indicates the audit process of financial statements conducted by external auditors from Big Four cannot detecting the occurrence of earnings management including material misstatements, fraud, and error which is in contrast with the idea of the external auditors that affiliated with Big Four will tend to publish a going concern audit opinion if the client has a problem concerning the company (Junaidi and Hartono, 2010). Besides, the reputation of auditors from Big Four companies which considered more qualified and competent with a series of training and procedures apparently unable to limit earnings management practices in Indonesia public banks, it does not support the research conducted by Sanjaya (2008) which proved that the auditors from the Big Four companies will strive earnestly to maintain their reputation so that the public will continue to give credence to the auditors.

The result of this research is in line with research conducted by Othman and Mersni (2016), Zgarni et al. (2018) and Laily (2017) who found no significant relationship between audit quality and earnings management. This results support the theory by Becker et al. (1998) that the company has its accounts audited by Big Six performs low tendency of committing earnings management compared to those by Non-Big Six. This research also revealed that the audit quality is not only determined by public accountant firm size and reputation of company that affiliated with Big Four due to the capable to detect any fraud committed by the management.

Based on agency theory, the principals do not trust agents to provide them with reliable and relevant information, and then they will hire external experts such as external auditor who are independence of these agents. The result of this research support the concept of agency theory by audit and assurance faculty in England and Wales (2005) where external auditors as agents of principals when performing an audit, which leads new concerns about trust, threats, objectivity and independence. Like management, the external auditors have their own desires and interests so that they tend to choose several methods to conduct earnings management in the company without concerns about their reputation and independence.

CONCLUSIONS

This research provides empirical evidence regarding the influences of corporate governance and audit quality on earnings management among Indonesian public banks. The independent variables used in this research are the independent board of commissioners, audit committee, institutional ownership, audit quality, while the control variable is company size. The dependent variable is earnings management proxied by discretionary loan loss provisions (DLLP).

The findings of this research revealed that earnings management through discretionary loan loss provision could be minimized by institutional ownership in Indonesian public banks. It implied that the higher institutional ownership in the public banks, the lower the opportunity of the
manager to manipulate earnings due to the institutional investors are more aware and well-informed than other shareholders because of their expertise, professionalism, and resources are all allowing them to optimize their monitoring. The presence of institutional ownership in banks improves the efficiency of governance as they have better access to information and greater expertise in achieving performance. The result of this study support agency theory where the institutional ownership is able to solve the agency problem arises in Indonesia which is a little separation of ownership and control. The other results also support agency theory that the bigger the company, the greater information asymmetry and agency conflict faced by public companies. The larger size of a company means the higher opportunity of the manager to manipulate earnings due to the larger chance for a company to earn profit from its business activity. The large companies are given more attention by the public so that they tend to have motive to be involved in earnings management and tend to maintain the condition of the company continually by showing the good profits that indicate the company achieves its targets. The big companies means the larger profitability of such company to choose an accounting method that will decrease profits with the purposes to decrease political cost by avoiding government actions under the political cost hypothesis.

However, results of this research show that an independent board of commissioners, audit committee, and audit quality do not effectively reducing earnings management in Indonesian public banks. It implied the proportions of independent commissioners and the size of audit committee is not enough to control discretionary behavior of managers. Instead, quality of the independent commissioners and audit committee should be more competent to monitor and evaluate the performance of company management continuously. Besides, the audit process of financial statements conducted by external auditors from Big Four cannot detect the occurrence of earnings management including material misstatements, fraud, and error in Indonesia public banks although they are considered more qualified and competent with a series of training and procedures. This research confirmed the concepts of external auditors are agents of the principals when performing an audit in the company. Therefore, this result highlights how important the external auditors must maintain its independence toward their clients.

**RESEARCH LIMITATIONS**

There are several limitations such as the low value of the coefficient of determination ($R^2$) indicates that the influence of the independent variables on the dependent variables is still weak and the results can cause a low level of validity in the hypothesis testing. The sample of this research is only focused on public banks listed in Indonesia Stock Exchange (IDX) and the period of research is only from 2014 until 2018 which causes the result of research is less generalized. The dependent variables used in this research is limited to show the real conditions of corporate governance in the company and earnings management practices in Indonesia.

**SUGGESTIONS**

Given the limitation above, future researchers are expected to employ a longer period of observation and expand the sample using all companies listed on
Indonesia Stock Exchange in order to get the insight of real conditions associated with the corporate governance and earnings management practices in Indonesia. The studies should provide information using other research variables so that they are better able to describe the actual conditions of company. Future research is expected to add insight and can provide a better conclusion later. The results of this research are expected to increase awareness of investors as well as stakeholders of the importance of the implementation of GCG in the company.

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