REAL EARNINGS MANAGEMENT AS MODERATING FACTOR ON THE INFLUENCE OF GOOD CORPORATE GOVERNANCE AND FINANCIAL DISTRESS TOWARDS QUALITY OF FINANCIAL STATEMENTS

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Abstrak: Manajemen Laba Riil sebagai Pemoderasi pada Pengaruh *Good Corporate Governance* & *Financial Distress* terhadap Kualitas Laporan Keuangan. Penelitian ini bertujuan untuk mengetahui: pengaruh positif Good Corporate Governance, pengaruh positif *Financial Distress* terhadap Kualitas Laporan Keuangan dengan Manajemen Laba Riil sebagai pemoderasi. Penelitian ini menggunakan pendekatan kuantitatif dengan populasi dari perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia periode 2015-2019 dengan menggunakan *purposive sampling* sebagai metode pengambilan sampel dengan hasil sebanyak 8 (delapan) sampel perusahaan. Teknik analisis data yang digunakan adalah uji regresi logistik dan *Moderated Regression Analysis*. Hasil penelitian menunjukkan bahwa: *Good Corporate Governance* tidak berpengaruh terhadap Kualitas Laporan Keuangan, *Financial Distress* tidak berpengaruh terhadap Kualitas Laporan Keuangan, Manajemen Laba Riil tidak dapat memoderasi hubungan pengaruh positif *Good Corporate Governance* terhadap Kualitas Laporan Keuangan, dan Manajemen Laba Riil tidak dapat memoderasi hubungan pengaruh positif *Financial Distress* terhadap Kualitas Laporan Keuangan.

Kata kunci: *Good Corporate Governance*, *Financial Distress*, Kualitas Laporan Keuangan, *Real Earnings Management*

Abstract: **Real Earnings Management as a Moderating Factor on the Influence of Good Corporate Governance & Financial Distress on The Quality of Financial Statements.** The aim of this study is to determine: the positive effect of Good Corporate Governance, the positive effect of Financial Distress on the Quality of Financial Statements with Real Earnings Management as a moderating factor. This study uses a quantitative approach with the study's population consisting of manufacturing companies listed on the Indonesia Stock Exchange from 2015 to 2019 period. Purposive sampling was used as a sampling method, with the results of 8 (eight) samples of companies. The logistic regression test and Moderated Regression Analysis were used to analyze the data. The results of this study indicate that: Good Corporate Governance has no effect on the Quality of Financial Statements, Financial Distress has no effect on the Quality of Financial Statements, Real Earnings Management cannot moderate the relationship between the positive influence of Good Corporate Governance on the Quality of Financial Statements, and Real Earnings Management cannot moderate the relationship between the positive influence of Financial Distress on the Quality of Statements.

Keywords: Good Corporate Governance, Financial Distress, The Quality of Financial Statements, Real Earnings Management

INTRODUCTION

Financial statements are a way through which companies communicate their financial situation to both external and internal parties. (Kieso et al, 2007). One of its benefits is used as a basis for decision

making, so its quality must be considered. Prudence is one of the principles used to maintain the quality of financial statements. Prudence is an act of prudence in recognizing income and assets first, then recognizing expenses more quickly in order to avoid the risks that will occur (Aristiani et al, 2017).

Financial reports must be presented in a transparent manner by management. However, prior to release of financial statements, management may make additional efforts to present the best side of the company in order to meet management and stakeholder expectations, simplify funding matters, etc (Stice & Skousen, 2011). There are companies in Indonesia that report overstated financial statements, namely PT Tiga Pilar Sejahtera Food Tbk (2017) and Garuda Indonesia (2018). If financial statements are not properly presented, the information becomes biased and cannot be used to make a decision.

Indonesia ranks lower than other ASEAN countries in the implementation of Good Corporate Governance (GCG), with a total score of 34% (CG Watch, Asian Corporate Governance Association, 2018). The low rating reveals that GCG implementation in Indonesia has not been maximized. GCG implementation can significantly reduce financial statements misstatements (Veronica & Bachtiar, 2005) and improve the quality of financial statements (Byard, Li & Weintrop, 2006). This research employs three GCG mechanisms: the Independent Board of Commissioners, Institutional Ownership, and the Audit Committee (Rohmah, 2017 and Ellen, 2013).

According to Boediono (2005), institutional ownership can monitor management through a monitoring mechanism, reducing fraudulent actions that affect the quality of financial statements. Then, the independent board of commissioners is expected to improve the quality of financial statements by encouraging the implementation of GCG & ensuring that the company complies with applicable laws & regulations (Nasr & Ntim, 2018). Then, an audit committee was formed to assist the board of commissioners in overseeing financial statements reporting performance, as well as the effectiveness of GCG & the integrity of financial statements (Rezaee, 2002).

Financial distress is a decline in financial condition that occurs before a company goes bankrupt (Platt & Platt, 2002). When the company is in financial distress, it receives a signal to increase its prudence. This is done to reduce potential conflicts between stakeholders. Moreover, these conditions will encourage company managers to be more cautious, resulting in higher-quality reported information and avoiding company management to increase

profits and misrepresentation (Lo (2006), Pramudita (2012), Sulastri & Anna (2018).

Earnings management occurs as a result of managers' authority over the accounting methods used in the financial statements in order to achieve specific goals. This is due to agency issues, which result in information asymmetry. Agency problems arise when managers want to maximize their profits while also having an obligation to prosper stakeholders. Because the scope of use of accrual earnings management is narrow (Carangelo & Ferrillo, 2016) and the application of accrual earnings management is also easier to track by auditors and regulators, this study employs real earnings management.

Real earnings management appears to moderate the relationship between GCG and financial statements quality, as well as the relationship between financial distress and financial statements quality. Because management has a conflict of interest, the existence of inequality earnings information will reduce the quality of a company's financial statements, making the financial statements less transparent in their presentation and weakening the implementation of GCG on the quality of financial statements (Arifin, 2005 in Manossoh, 2016).

Then, according to Scott (2006)'s earnings management concept, namely efficient earnings management, companies use earnings management to protect themselves and overcome unexpected events (financial distress) while also maintaining existing contracts.

Based on the differences in results in previous research and the data periods that only range from 2 to 3 years, the researcher intended in conducting a study entitled: "Real Earnings Management as a Moderating Factor on The Influence of Good Corporate Governance & Financial Distress on The Quality of Financial Statements". The aim of this research is to examine the impact of GCG & Financial Distress on the quality of financial statements and moderated by real earnings management.

LITERATURE REVIEW

Agency theory is the core point of the relationship between principal and agent. The principal hires agents to perform tasks for the benefit of the principal, and the agent is also given decision-making authority. (Anthony & Govindarajan, 2005). Then, as a result of the agency problem, another term emerges that is information asymmetry. It is a condition where the internal parties have more information than the external parties (Clarkson, Jacobsen & Batcheller (2007), Suwardjono (2014), Vania, Nugraha & Nugroho (2018)).

Signal theory emerges as a result of information asymmetry between the company & external stakeholders. The signal

is intended to indicate that the agent has more information about the company's current state than the principal (Gumanti, 2009). According to Bird in the Hand theory, investors prefer to receive profit in terms of dividends rather than waiting for more uncertain capital gains (Pontoh, 2015). To connect with the quality of financial statements, the company may fail to apply prudence, because the company's manager allows dividend payments to be smooth and gives investors a positive impression of the company's condition.

Good Corporate Governance is a principle that governs managers, controllers, directors, employees, and other stakeholders (Wahyudin & Solikha, 2017). This study employs 3 GCG mechanisms. One of the GCG elements that can be used is Institutional Ownership. Institutional ownership is able to control management through a monitoring mechanism, so it can reduce fraudulent actions of management which will reduce the quality of financial statements (Boediono, 2005).

Another component is an Independent Board of Commissioner. Its role is to encourage GCG implementation and ensure that the company complies with applicable laws and regulations, which is expected to improve the quality of financial statements (Nasr & Ntim, 2018). Then, an audit committee was formed to assist the board of commissioners in overseeing financial statement reporting performance, as well as the effectiveness of GCG and the integrity of financial statements (Rezaee, 2002). The effectiveness of the 3 GCG components mentioned above is expected to improve the quality of financial statements (Jama'an (2010), Astria & Ardiyanto (2011), Rohmah (2017) and Hajawiyah, et al (2020)).

Financial distress is a decline in financial condition before a company goes bankrupt (Platt & Platt, 2002). Managers of companies in financial distress tend to increase prudence in order to avoid conflicts between stakeholders and make managers more careful in reporting financial statements, which has an impact on increasing the quality of financial reports & reducing inappropriate financial statements (Lo (2006), Pramudita (2012), and Sulastri & Anna (2018)).

According to Fanani (2009), the quality of financial statements can be seen from two perspectives. First, the quality of financial statements can be seen from overall company performance, which is reflected in company profits. Second, the quality of financial statements can be determined by their relationship to capital market performance, which is reflected in the form of incentives. Prudence is currently used in the concept of financial statements quality. According to Siahaan et al (2018), in prudence, revenue recognition or asset transactions are recorded when they occur

and expenses are recorded as soon as possible.

Roychowdhury (2006) defines real earning management as a: “departures from normal operational practices, motivated by manager’s desire to mislead at least some stakeholders into believing certain financial reporting goals have been met in the normal course of operations”. Earnings management is divided into two approaches: accrual earnings management and real earnings management.

Earnings management occurs as a result of managers' authority over the accounting methods used in the financial statements in order to achieve specific goals. This is due to agency issues, which result in information asymmetry. Agency problems arise when managers want to maximize their profits while also having an obligation to prosper stakeholders. Real earnings management appears to moderate the relationship between GCG and financial statements quality, as well as the relationship between financial distress and financial statements quality. Because management has a conflict of interest, the existence of inequality earnings information will reduce the quality of a company's financial statements, making the financial statements less transparent in their presentation and weakening the implementation of GCG (Arifin, 2005 in Manossoh, 2016).

According to Scott (2006)'s earnings management concept, namely efficient earnings management, companies use earnings management to protect themselves and overcome unexpected events (financial distress) while also maintaining existing contracts.

Based on the theoretical studies that have been described previously, the proposed hypotheses are:

H_{a1} : Good Corporate Governance has a positive influence on the Quality of Financial Statements.

H_{a2} : Financial Distress has a positive influence on the Quality of Financial Statements.

H_{a3} : Real Earnings Management moderates the positive influence between the influence of Good Corporate Governance on the Quality of Financial Statements.

H_{a4} : Real Earnings Management moderates the positive influence between the influence of Financial Distress on the Quality of Financial Statements.

METODE PENELITIAN

Research Design

The researcher uses a causal-comparative design to see if the independent variables can influence the dependent variable. Because the data is in numerical form, this study is referred to as quantitative research.

Place & Time of Research

This study is conducted on manufacturing companies listed on the Indonesia Stock Exchange from 2015-2019. The execution of this research starts from January 2021 until July 2021.

Population and Sample

The data population in this study are manufacturing companies listed on the IDX for the 2015-2019 period. The researcher used purposive sampling to select the sample based on the following criteria:

1. Manufacturing companies that have been consistently listed on the Indonesia Stock Exchange from 2015 to 2019 and have published annual reports
2. Manufacturing companies listed on the Indonesia Stock Exchange that use Rupiah in their annual reports for the 2015-2019 period
3. Manufacturing companies listed on the Indonesia Stock Exchange with independent boards of commissioners, audit committees, and institutional ownership for the 2015-2019 period
4. Manufacturing companies listed on the Indonesia Stock Exchange from 2015 to 2019 that are not in financial distress and are in financial distress.

Data Collection Instrument

1. Good Corporate Governance (GCG)

   The formula for calculating GCG is as follows:

   a. Independent Board Commissioner

   $$\frac{\text{Total of Independent Commissioner}}{\text{Total of Board of Commissioner}}$$

   (Susanti & Mildawati, 2014)

   b. Institutional Ownership

   $$\frac{\text{Total of shares owned by Institutional}}{\text{Total of outstanding shares}}$$

   (Hajawiyah, et al. 2020)

   c. Audit Committee

   Audit Committee = Total of Audit Committee Member

   (Al-Mamun, et al, 2014)

2. Financial Distress

   The formula for calculating Financial Distress is as follows:

   $$Z = 1{,}2\,X_1 + 1{,}4\,X_2 + 3{,}3\,X_3 + 0{,}6\,X_4 + 1\,X_5$$

   (Altman, 1968)

   Explanation:

   X_1 = Working Capital/Total Asset

   X_2 = Retained Earnings/Total Asset

   X_3 = Earning Before Income & Tax/Total Asset

   X_4 = Market Value of Equity/Total Asset

   X5 = Sales/Total Asset

Furthermore, this variable is labeled with a dummy variable. With the following conditions: 1, if the company experiences financial distress, and 0 if the company does not experience financial distress.

3. The Quality of Financial Statements

The formula for calculating The Quality of Financial Statements is as follows:

$$CONACC = (NI - CFO)$$

(Givoly & Hayn, 2002)

Explanation:

NI = Net Income before extraordinary item deducted depreciation and amortization

CFO = Cash flow from operational activity

Furthermore, this variable is labeled with a dummy variable. With the following conditions: 1, if the company apply prudence and 0 if the company does not apply prudence.

4. Real Earnings Management

The formula for calculating Real Earnings Management is based on Roychowdhury (2006):

a. Abnormal Cash Flow Operation (ABN_CFO)
b. Abnormal Discretionary Expenses (ABN_DISEXP)
c. Abnormal Production (ABN_PROD)

Data Analysis Method

The analysis method that used in this study is logistic regression. Logistic regression analysis was used to analyze quantitative data that categorically reflected the results, with the goal of testing the probability of the dependent variable being predictable with the independent variable. The stages of data analysis in this study are as follows:

1. Precondition Data Test
   a. The Multicollinearity Test

   The Multicollinearity test determines whether or not the independent variables have a strong correlation. The Multicollinearity test can be seen by using VIF (Variance Inflation Factor). If the tolerance value is ≧ 0,10 and the VIF value is ≧ 10, there is no multicollinearity.
2. Model Fit Test
   a. Hosmer and Lemeshow’s Goodness of Fit Test

   The null hypothesis is rejected if the value of Hosmer and Lemeshow's Goodness of Fit is < 0,05. If the value of Hosmer and Lemeshow's Goodness of Fit is > 0,05, the null hypothesis cannot be rejected, indicating that the model can predict the value of the

observation or that the model can be accepted because it fits the data.

b. Log Likelihood Value Test

This test determines whether the hypothesized model and the sample data acquired are compatible. The regression model is improving if the value of -2LL in the first block (block number = 0) is higher than the value of -2LL in the second block (block number = 1) (Ghozali, 2018).

c. Cox and Snell R Square and Nagelkerke R Square Test

This test aims to find the determined value such as R square in a multiple test regression. Because the values range from 0 to 1, the Nagelkerke R Square Test is used instead of the Cox and Snell R Square Test.

3. Regression Test

Data analysis techniques in this study use logistic regression test and moderated regression analysis.

4. Hypothesis Testing

The hypothesis results can be seen by comparing the significance value at the 5% level. If the significance value is less than the significant value, the research hypothesis is accepted or the independent variable influences the dependent variable and vice versa.

RESEARCH RESULTS AND DISCUSSION

Data Description

After excluding outliers, there are 8 companies with a research period of 5 years (2015-2019), so the amount of data used in this study is 40 (8 x 5 = 40). (2015-2019), so the amount of data used in this study is 40 (8 x 5 = 40).

Table 1. Descriptive Statistical Test Results

The Multicollinearity Test

Tabel 2. The Multicollinearity Test Result

Variable	Tolerance	VIF
GCG	0,960	1,042
FD	0,875	1,142
REM	0,895	1,118

Table 2 shows that all independent variables have a ≦ 0,10 Tolerance value and a ≧ 10 VIF (Variance Inflation Error). It came to the conclusion that the data in this study did not show any signs of multicollinearity.

Model Fit Test Result

1. -2 Log Likelihood Test

Table 3. The -2Log Likelihood Test Result

	N	*Min*	*Max*	*Mean*	*SD*
GCG	40	1,75	3,24	2,3145	0,52221
FD	40	0,00	1,00	0,2500	0,43853
KL	40	0,00	1,00	0,7250	0,45220
REM	40	0,34	1,78	0,7780	0,33776

Step	-2 Log likelihood
0	47,054
1	36,731

There's a decreasing value from -2 Log Likelihood Test block number=0 to block number=1. It means that the regression model is better for determining the level of Quality of Financial Statements in Manufacturing Companies listed on the Indonesia Stock Exchange from 2015 to 2019.

2. Hosmer and Lemeshow's Goodness of Fit Test

Table 5. Hosmer and Lemeshow's Goodness of Fit Test Result

Step 1	Chi-Square	Sig	Conclusion
1	7,522	0,481	Model Accepted

The Goodness of Fit test generated a Chi-Square value of 7,522 and a Sig value of 0,481 (0,481 > 0,05). Therefore, this regression model can be used for further analysis.

3. **Cox and Snell R Square and Nagelkerke R Square Test**

Table 6. Cox & Snell R Square & Nagelkerke R Square Result Test

Step	Cox & Snell R Square	Nagelkerke R Square
1	0,227	0,329

According to Table 6, Nagelkerke R Square has a coefficient value of 0,329, indicating that the ability of the GCG, Financial Distress, and Real Earnings Management variables to explain the Financial Statements Quality variable is only 32,9%, with the remaining 67,1% explained by variables outside the model.

4. Hypothesis Testing

Table 7. Hypothesis Testing Result

Variabel	β	Wald	Sig.
GCG	1,459	2,332	0,127
FD	20,441	0,000	0,999

Table 8. Moderated Regression Analysis Result

Variabel	Coefficient	t	Sig.
M1_GCG_REM	-0,660	-0,976	0,336
M2_FD_REM	0,013	0,011	0,991

Based on the hypothesis testing result above, it is possible to explain that:

Good Corporate Governance (GCG) variable does not affect the Quality of Financial Statements. Based on Table 7, the GCG variable has a coefficient value of 1,459 with a significance value of 0,127 which is greater than 0,05. The following factors can lead to this rejection is Institutional Ownership which the implemented policies by

management have little effect on institutional investors. Furthermore, they are more concerned with dividends and capital gains. As a result, if management applies prudence, the benefit to investors will be modest. Then, the Independent Board of Commissioners and Audit Committee as a supervisor, there is a possibility of a lack of supervision. According to Sari & Hapsari (2018), the audit committee's scope is limited to separate accounting and financial information and is not directly involved in solving internal problems. This study's findings are consistent with Hidayat & Elisabet (2010), Sari & Hapsari (2018), and Tussiana & Lastanti (2016).

Financial Distress does not affect the Quality of Financial Statements. Based on Table 7, the Financial Distress variable has a coefficient value of 20,441 with a significance value of 0,999 which is greater than 0,05. The following factors can lead to this rejection is while the company is in financial distress, they are hesitant to apply prudence in its financial statements. This happens because the manager will gain a bad reputation and may face resignation because they negatively affected the company. This is accomplished by increasing the company's profits so that creditors and investors will continue to lend and invest in the company. These results are similar to Totong & Majidah (2020), Haryadi, Sumiati & Umdiana (2020), also Putri & Herawaty (2020).

Real Earnings Management does not moderate the positive influence between Good Corporate Governance to the Quality of Financial Statements. Based on Table 8, the t-test has a value of 0,690 with a significant value of 0,336, which is greater than 0,05. This finding supports the notion that GCG is an important factor in influencing the quality of information in financial statements. GCG is aimed at reducing agency problems and information asymmetry (Elbadry, Gounopoulos & Skinner, 2015). Furthermore, GCG influences financial statement disclosure to the better quality ((Dechow et al (1996) in Byard, Li & Weintrop (2006)). Also, the consistent use of a GCG mechanism can reduce performance engineering practices that can cause the company's financial statements to be untrustworthy (Manossoh, 2016).

Real Earnings Management does not moderate the positive influence between Financial Distress to the Quality of Financial Statements. Based on Table 8, the t-test has a value of 0,013 with a significant value of 0,991, which is greater than 0,05. Companies in financial distress typically do not engage in earnings management because they are either too deep in distress to manipulate and manage earnings prior to the distress, or they have not reaped the benefits of the

manipulation (Demirkan & Platt, 2009). Furthermore, real earnings management is carried out through a firm's economic activities such as abnormal cash flow, abnormal discretionary expenses, and abnormal production in several company's operational activities, which typically involves many aspects and incurs a higher cost (Li, Y., et al, 2020). This results are similar to Herawaty & Rahardja (2019).

CONSLUSION AND SUGGESTION

Conclusion

1. Good Corporate Governance does not affect the Quality of Financial Statements.
2. Financial Distress does not affect the Quality of Financial Statements.
3. Real Earnings Management does not moderate the positive influence between Good Corporate Governance to the Quality of Financial Statements.
4. Real Earnings Management does not moderate the positive influence between Financial Distress to the Quality of Financial Statements

Research Limitation

The following limitations impose to this study:

1. This study uses up to 14 samples from manufacturing companies listed on IDX from 2015 to 2019. However, due to outliers, this has been reduced to only 8 samples.
2. Good Corporate Governance variable measurement only refers to Institutional Ownership, Independent Board of Commissioner and Audit Committee.
3. According to the Nagelkerke R square test results, only about 32,9% of the independent variables can explain the dependent variables. It is hoped that other independent variable will be used in future research.

Suggestion

Based on the conclusions and results of this research, the following suggestions are proposed:

1. Further research can use another type of company sectors such as service companies, property and real estate, mining, etc.
2. Further research can use independent variables other than GCG and financial distress.
3. Further research can use other proxies to calculate existing variables, especially the quality of financial statements.

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