

# Board Characteristics and Earning Management

BERNARDUS Y NUGROHO AND UMANTO EKO

*Department of Administration Science, Faculty of Social and Political Science, Universitas Indonesia*  
bernardus.yuliarto@ui.ac.id; umanto@ui.ac.id

**Abstract.** Corporate governance is a concept where management supervision takes place in the decision-making process, both in public and business organizations. This research reviews the effect of board characteristics (measured based on the independent board of directors, dual leadership/CEO duality, board size, managerial ownership, board composition /multiple directorships, board tenure, audit committee, and board interlock) on earning management in companies listed in the Indonesian Stock Exchange during the 2004-2008 period. To identify earning management, the researcher uses the Jones model (1991) as modified by Dechow and Sloan (1996) to separate non-discretionary accrual (NDAC) components from discretionary accrual components (DAC) in the total accrual. The research shows that earning management takes place in companies listed in the Indonesian Stock Exchange during the 2004-2008 period, be they companies in general, manufacturers, non-manufacturers, and companies that use audit committee services. It is discovered that the independent board of directors, board size, managerial ownership, board composition/multiple directorships, board tenure, and audit committee do not affect earning management practices in the above companies; only dual leadership/CEO duality affects the earning management practices.

**Keywords:** *corporate governance, earning management*

## INTRODUCTION

Corporate governance is a concept where management supervision takes place in the decision-making process, both in public and business organizations. In the decision-making process, corporate governance must be implemented, as one of its requirements is a firm and sound organizational management. Syakhroza (2004) states that the leadership (board of commissioners and board of directors) quality plays a vital role in the implementation of corporate governance. The board of commissioners acts as the company supervisor, while the board of directors is responsible for the company's operational activities. Both boards have the full responsibility and authority in deciding the means to direct, control, and supervise the management of resources in accordance with the company's objectives. Nevertheless, a conflict of interest often arises between them. Although the board of commissioners, as the dispenser of authority, has a stronger legal position than the board of directors, it also has less access to the information on the company's situation. One of the solutions is to use the financial report as an instrument in assessing the board of directors' performance. However, through specific methods, the board of directors often manipulates the financial report in the recording of the company's bookkeeping activities. In accounting

and financial practices, the manipulation is called earning management. It is not a harmful practice, as it is based on the belief that the board of directors should present a good financial report with good records at every period. Naturally, less or no earning management means more truthful information in the financial report. The board of commissioners risks receiving a financial report that the board of directors has manipulated, in order for the latter to receive commendation for their performance. When this problem arises, the board of commissioners can use the board of directors' characteristics to assess their true performance.

According to Healy and Wahlen (1999), the most common reason for earning management is to improve compensation and job security. They define earning management as something that "occurs when 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." Furthermore, they provide the following descriptions for earning management: (1) there are many ways that managers can exercise judgment in financial reporting; (2) the objective of earning management as being to mislead stakeholders (or some class of stakeholders) about the underlying

economic performance of the firm; and (3) management's use of judgment in financial reporting has both cost and benefits. The costs are the potential misallocation of resources that arises from earning management. Benefits include potential improvements in the management's credible communication of private information to external stakeholders improving in resource allocation decisions.

Earning management is also an anticipatory step to avoid an in-default situation in a loan agreement, reduce the regulatory cost, and increase the regulatory benefit (Cornett et al., 2008). Simply put, the objective of earning management practices is to obtain benefit for the company. The benefit is linked to the management's efforts in regulating certain incomes or profits for certain purposes that are directly or indirectly related to the company's interests. Schipper (1989) defines earning management as "disclosure management in the sense of purposeful intervention in the external reporting process, with the intent of obtaining some private gain." Ayres (1994) defines profit management as "an intentional structuring of reporting or production/investment decisions around the bottom line impact. It encompasses income smoothing behavior but also includes any attempt to alter reported income that would not occur unless management were concerned with the financial reporting implications." Based on these two definitions, we can conclude that earning management has two interrelated aspects. First, due to misallocation of the company's potential resources, earning management can lead to extra costs for the company. Second, earning management can become a positive factor when the management is able to utilize it for the company's benefit. Rosenzweig and Fischer (1994) in Gumanti (2000) states that earning management consists of "the actions of manager that are intended to increase (decrease) current reported earnings of the unit for which the manager is responsible without generating a corresponding increase (decrease) in the long-term economic profitability of the unit."

The board of commissioners' independence and the audit committee's existence contribute to corporate governance. The two factors are the main focus for Indonesia's Securities and Exchange Commission and Regulator, namely the Jakarta Stock Market and Bapepam (Indonesian Capital Market and Financial Institution Supervisory Agency). Another mechanism that becomes the focus in the implementation of corporate governance is the stock ownership structure. Institutional stock ownership and insider/managerial stock ownership may become a supervisory mecha-

nism that reduces the amount of asymmetric information between investor and insider. Leverage policy and independent auditors can also impose an external supervisory mechanism that limits the moral hazard for insiders.

Fama and Jensen (1983) believe that the board of commissioners is a vital element in implementing corporate governance; essentially, it is implemented in order to protect and supervise the investors' assets, and no supervisory mechanism, even delegating the supervision to other parties, is more effective than direct supervision by stockholders. According to Klein (2002), an independent board of directors can run a more effective supervision. Cornett et al. (2008) state that operational performance and stock return will improve as the number of independent commissioners increases. Liu and Lu (2007) state that board structure does not only control the financial reporting process, but also prevents controlling shareholders from doing activities that may harm other stockholders. In addition, Beasley (1996) discovers that financial report manipulation decreases in companies where the board of commissioners have more members. Alonso et al. (2000) discover a positive connection between the number of members in the board of directors and earning management practices. Anderson, Mansi and Reeb (2003) discover a lower cost of debt in companies where the board of commissioners have more members. Next, Weir, et al. (2002) and Ho dan Williams (2003) believe that board effectiveness tends to increase when the company has non-executive directors (equivalent to independent commissioners), as non-executive directors have more independence in the management (Mangena, 2007). A study by Anderson, Mansi, dan Reeb (2003) also finds that board tenure is positively linked to corporate debt yield. This shows that effective supervision is most probably caused by the company board's abilities, implying that a board with a long tenure tends to run a good supervision in order to achieve the company's goals (Beasley, 1996 in Anderson, et al., 2003).

Chief Executive Officer (CEO) duality indicates a manager's dual role in the company. The phenomenon is described by Gul and Leung (2004), Booth, et al. (2004), and Ho and Wong (2001). They state that the CEO duality phenomenon enables a manager to simultaneously occupy two positions: the CEO and the chairperson of the board. The duality also results in power concentration in the hand of one leader, which will lead to management discretion. Research by Cornett et al. (2008) reveals that the separation of CEO and board chairperson will encourage a more efficient and effective supervision. Balinga,

Moyer and Rao (1996) find that CEO duality has a negative effect on market performance. This statement is augmented by Daily and Dalton (1997), who discover CEO duality's negative effect on company performance.

In relation to board size, Fatma (2008) discovers that it has a positive effect on company leverage - specifically, in real estate and property companies listed in the Indonesian Stock Exchange. The separation of ownership from management leads to a conflict of interest between them. The manager, supposedly the agent that works to optimize investor interest, has a personal agenda to improve their own well-being, using resources that rightfully belong to the investors. Jensen and Meckling (1976) state that the incentive for the management to act in accordance with the investors' wishes is influenced by the level of corporate stock ownership in the management itself. Managers with corporate stocks have the same objectives as the other stockholders; this will control the management's internal behavior. The more stocks the management owns, the further its objective will match the stockholders'. Ang et al. (2000) finds no agency fees in single owner-manager companies, whereas agency fees are found in companies where the manager owns less than 100% of the stocks. Thus it can be concluded that agency fees are negatively linked to the ownership percentage; the more non-manager shareholders there are, the higher the agency fees.

Board composition refers to the number of independent commissioners in comparison with the total of the board of commissioners' members. The board composition must enable an effective, accurate, and fast decision-making. Independent commissioners have the task to ensure a balanced decision-making, especially to protect minority stockholders and other relevant parties.

Board tenure is a board's tenure in the company. The tenure will provide the board with the experience and abilities to control and supervise the company's activities. This in turn will support the board's effectiveness in doing its functions in the company, and this is an important part of corporate governance which ensures the implementation of company strategies, supervision of the management in their tasks, and accountability.

Independent auditors are responsible for external supervision. They examine financial reports from the corporation and then give their assessment of the reports. They are expected to notice inconsistencies in the reports and report these inconsistencies to the board of commissioners or audit committee. The audit committee's presence alone may reduce earning management practices (Klein, 2002). This is in accordance with Lin's (2006) research, which reveals that an audit committee may reduce the company management's earning management practices.

Board interlock occurs when a board implements interlocking directorship in the company. Interlocking directorship refers to a board in one company that also functions as a board in another. The board may be the supervisory board in one company and the management board in another. Interlocking directorship contributes positively to a company, in that the company will receive more information on its external environments. The research by Rommens, Cuyvers and Deloof (2007) discovers a significantly negative connection between board interlock and company leverage. The research also finds that a board from a company with a high leverage is a rather unattractive board candidate for other companies (Rommens, Cuyvers and Deloof, 2007).

The research aims to estimate the effect of board characteristics (measured based on the independent board of directors, dual leadership/CEO duality, board size, managerial ownership, board composition/multiple directorships, board tenure, audit committee, and board interlock) on earning management in companies listed in the Indonesian Stock Exchange during the 2004-2008 period. To detect earning management, the researcher uses the Jones model (1991) as modified by Dechow and Sloan (1996) to separate non-discretionary accrual (NDAC) components from discretionary accrual components (DAC) in the total accrual. The research is limited by concepts related to board characteristics, measured based on the independent board of directors, dual leadership/CEO duality, board size, managerial ownership, board composition/multiple directorships, board tenure, audit committee, and board interlock. It is our hope that the research will provide both a theoretical contribution (from the business and administrative perspective) and a practical one. Theoretically, the research is intended to provide a complete overview of the earning management and corporate governance concepts. Practically, the research is intended to provide an actual contribution to the development of reviews related to earning management and to the anticipatory steps to reduce it taken by corporations that implement corporate governance.

## METHODOLOGY

The research uses the quantitative approach and secondary data obtained from various sources. It is an explanatory research, examining the connection between dependent variables (earning management) and independent variables (board characteristics). The population taken as the samples consists of all the companies listed in the Indonesian Stock Exchange during the 2004-2008 period. The researcher uses the non-probability sampling technique and purposive sampling method. The popula-

**Table 1. Operationalizing the Concept**

No	Variable	Definition
1	<i>Independent Board of Director (Independent BOD)</i>	A number of people appointed by stockholders to hold the highest authority in a corporation, to establish the policies for corporate activities.
2	<i>CEO Duality</i>	A manager's dual role in a company.
3	<i>Board Size</i>	A board's size/number of members. As the board occupies the highest rank in the internal management system, it is tasked with supervising and controlling the company.
4	<i>Managerial Ownership</i>	The number of stocks owned by the management, board of directors, or board of commissioners.
5	<i>Board Composition</i>	The number of independent commissioners in comparison with the board of commissioners' total members. The board composition must enable an effective, accurate, and fast decision-making.
6	<i>Board Tenure</i>	A board's tenure in a company, or the period during which the board occupies its position.
7	<i>Board Interlock</i>	A board involved in interlocking directorship.
8	<i>Audit Committee</i>	Independent auditors tasked with external supervision.

tion taken as the samples meets the following criteria: (1) Their stocks are not part of the financial industry, as such stocks are highly regulated and characteristically different from stocks in other industries; for instance, in their capital structure and presentation of financial report; (2) The companies taken as samples have complete financial reports which contain all the variables required in this particular research model.

To identify earning management, the research uses the Jones model (1991) as modified by Dechow and Sloan (1996), referred to as the m-Jones model, to separate non-discretionary accrual (NDAC) components from discretionary accrual components (DAC) in the total accrual. Below are the stages to obtain the DAC value:

1. Counting the total accrual value (TACC) using the following formula:

$$\text{TACC} = \text{Net Income} - \text{Cash Flow from Operation} \quad \dots\dots\dots(1)$$

(Source: Teoh et al., 1998)

2. Counting the values of NDAC and DAC by inserting the TACC value into the m-Jones regression equation.

$$\frac{\text{TACC}_i}{\bar{A}_{i-1}} = a_1 \left[ \frac{1}{\bar{A}_{i-1}} \right] + a_2 \left[ \frac{\Delta \text{REV}_i - \Delta \text{REC}_i}{\bar{A}_{i-1}} \right] + a_3 \left[ \frac{\text{PPE}}{\bar{A}_{i-1}} \right] + \hat{a}_i \quad \dots\dots\dots(2)$$

Basically, the m-Jones model is a weighted least square model that aims to obtain the values for  $a_1$ ,  $a_2$ , and  $a_3$ . Based on the coefficients in the regression ( $a_1$ ,  $a_2$ , and  $a_3$ ), non-discretionary accrual and discretionary accrual components in each issuer used as a research sample are

separated. As the income or sales (REV) and fixed assets value (PPE) components indicate business growth, the accrual values in the components are considered normal and not categorized as management discretion. Therefore, the NDAC value calculation uses the following formula (Teoh et al., 1998):

$$\text{NDAC}_i = \hat{a}_1 \left[ \frac{1}{\bar{A}_{i-1}} \right] + \hat{a}_2 \left[ \frac{\Delta \text{REV}_i - \Delta \text{REC}_i}{\bar{A}_{i-1}} \right] + \hat{a}_3 \left[ \frac{\text{PPE}}{\bar{A}_{i-1}} \right] + \hat{a}_i \quad \dots\dots\dots(3)$$

3. Counting the DAC value using the following equation (Teoh et al., 1998):

$$\text{DAC}_i = \frac{\text{TACC}_i}{\bar{A}_{i-1}} - \text{NDAC} \quad \dots\dots\dots(4)$$

where:

$\text{TACC}_{it}$  = Total accrual of issuer i on year t

$\text{NDAC}_{it}$  = Non-discretionary accruals for issuer i on year t

$\text{DAC}_{it}$  = Discretionary accruals for issuer i on year t

$\Delta \text{REV}_{it}$  = Change in income value for issuer i on year t compared to years t-1

$\Delta \text{REC}_{it}$  = Change in account receivable for issuer i on year t compared to years t-1

$\text{PPE}_{it}$  = Fixed assets value for issuer i on year t

$\text{TA}_{it-1}$  = Fixed assets value for issuer i on year t

Aggressive earning management is based on the discretion or judgment of the manager as the person who presents the profit report. After the discretionary and non-discretionary accrual values have been separated, the next step is to regress the discretionary accrual value with

**Table 2. Statistical description of companies listed in the Indonesian Stock Exchange during the 2004-2008 period**

	EM	Ind_BOD	CEO_Dual	B_Size	Mgr_Own	B_Comp	B_Tenr	B_Intr
Mean	0.0666	1.3764	0.1170	4.1755	0.0180	0.3275	0.0887	0.0896
Std. Error of Mean	0.0090	0.0542	0.0159	0.1152	0.0030	0.0082	0.0098	0.0197
Median	0.0620	1	0	3.60E+00	0.00012	0.33	0	0
Mode	-.37558 <sup>a</sup>	1	0	3	0	0.33	0	0
Std. Deviation	0.1311	0.7885	0.2318	1.6771	0.0439	0.1192	0.1420	0.2863
Variance	0.0170	0.6220	0.0540	2.8130	0.0020	0.0140	0.0200	0.0820
Range	1.3373	5	1	9	0.25719	0.67	0.6	1
Minimum	-0.3756	0	0	2	0	0	0	0
Maximum	0.9617	5	1	11.00	0.26	0.67	0.60	1
Sum	14.1249	2.9E+02	24.80	885.20	3.81	69.43	18.80	19.00
N	212	212	212	212	212	212	212	212

a. Multiple modes exist. The smallest value is shown

the constitutive variables for the corporate governance's characteristics.

Below is the analysis model used in this research:

$$DAJ_{it} = \beta_0 + \beta_1 InBOD + \beta_2 DUAL + \beta_3 BSIZE + \beta_4 MO + \beta_5 BC + \beta_6 BT + \beta_7 AUD + \beta_8 BI + \epsilon$$

where:

DAC	= Discretionary accrual
InBOD	= Independent board of director
DUAL	= Dual leadership/CEO duality
BSIZE	= Board size
MO	= Managerial ownership
BC	= Board composition
BT	= Board tenure
AUD	= Audit committee
BI	= Board interlock

The hypotheses in this research are:

1. Earning management practices exist in companies listed in the Indonesian Stock Exchange during the 2004-2008 period.
2. The independent board of directors is negatively linked to earning management.
3. The dual leadership/CEO duality is positively linked to earning management.
4. Board size is negatively linked to earning management.
5. Managerial ownership is negatively linked to earning management.
6. Board composition/multiple directorships is negatively linked to earning management.
7. Board tenure is negatively linked to earning management.
8. The audit committee is negatively linked to earning

management.

9. Board interlock is positively linked to earning management.

Below are the stages in this research:

1. Collecting research samples, namely from companies listed at the Indonesian Stock Exchange during the 2001-2006 period.
2. Eliminating several samples with the purposive sampling method. The criteria for the elimination are companies that: (1) are in the financial industry, and (2) do not have the required variables for the research.
3. Listing the earning management variables data in a Microsoft Excel document.
4. Calculating the total accrual, non-discretionary accrual, and discretionary accrual values using the m-Jones model and the following softwares: EViews and Microsoft Excel.
5. Listing the corporate governance variables data in a Microsoft Excel document
6. Pooling the data to test the hypothesis testing model using EViews.
7. Analyzing research results and drawing conclusions from the research.

## RESULT AND DISCUSSION

### Statistical description of companies listed in the Indonesian Stock Exchange during the 2004-2008 period

Using the purposive sampling method, the research has collected samples that consist of 212 companies. The following table shows the statistical description of all the



**Table 3. Statistical Description: Discretionary Accrual Values**

Mean	0.0666
Standard Error	0.0090
Median	0.0620
Mode	#N/A
Standard Deviation	0.1311
Sample Variance	0.0172
Kurtosis	12.7335
Skewness	1.8436
Range	1.3373
Minimum	-0.3756
Maximum	0.9617
Sum	14.1249
Count	212

**Table 4. Testing the earning management practices**

	T	df	Sig. (2-tailed)	Mean Difference	95% Confidence Interval of the Difference	
					Lower	Upper
EM	7.403	211	.000	.06662710	.0488845	.0843697

**Table 5. Model Summary**

	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
Independent Board of Director on Earning Management	.012	.000	-.005	.13135210	2.152
Dual Leadership/CEO Duality on Earning Management	.133	.018	.013	.13019321	2.165
Board Size on Earning Management	.044	.002	-.003	.13123745	2.144
Managerial Ownership on Earning Management	.025	.001	-.004	.13132206	2.153
Board Composition on Earning Management	.043	.002	-.003	.13123957	2.156
Board Tenure on Earning Management	.032	.001	-.004	.13129624	2.156
Board Interlock on Earning Management	.074	.005	.001	.13100128	2.151
Independent Variables on Earning Management	.158	.025	-.008	.13160164	2.157
Multivariate Testing	.154	.024	.005	.13072975	2.163

a Predictors: (Constant), Ind\_BOD

b Dependent Variable: EM

variables used in this research.

Table 2 shows the median value of the earning management to be 0.0666 and 0.0620, with a maximum value of 0.9617 and a minimum value of -0.3756. These values indicate that, in their earning management practices, the companies tend more toward income increasing than income decreasing. This can be seen from the positive discretionary accrual values (Table 3). The average discretionary accrual value is 0.0666, with a maximum value of 0.9617 and a minimum value of -0.3756. The positive discretionary accrual value indicates the compa-

nies' effort to show a good performance, in the hope of attracting investors into making short-term and long-term investments.

The independent board of commissioners (Ind\_Bod) refers to the number of independent commissioners in a company. The mean value is 1.3764, with a maximum value of 5 and a minimum value of 0. CEO duality indicates a manager's dual role in a company. 1 is given as a score when the manager in a company has a dual role, and 0 is given when the manager does not have a dual role. The mean value for CEO duality is 0.1170, with a

**Table 6. Anova**

		Sum of Squares	Df	Mean Square	F	Sig.
Independent Board of Director on Earning Management	Regression	.001	1	.001	.032	.858
	Residual	3.623	210	.017		
	Total	3.624	211			
Dual Leadership/CEO Duality on Earning Management	Regression	.064	1	.064	3.788	.053
	Residual	3.560	210	.017		
	Total	3.624	211			
Board Size on Earning Management	Regression	.007	1	.007	.399	.528
	Residual	3.617	210	.017		
	Total	3.624	211			
Managerial Ownership on Earning Management	Regression	.002	1	.002	.128	.721
	Residual	3.622	210	.017		
	Total	3.624	211			
Board Composition on Earning Management	Regression	.007	1	.007	.392	.532
	Residual	3.617	210	.017		
	Total	3.624	211			
Board Tenure on Earning Management	Regression	.004	1	.004	.211	.647
	Residual	3.620	210	.017		
	Total	3.624	211			
Board Interlock on Earning Management	Regression	.020	1	.020	1.159	.283
	Residual	3.604	210	.017		
	Total	3.624	211			
Independent Variables on Earning Management	Regression	.091	7	.013	.748	.632
	Residual	3.533	204	.017		
	Total	3.624	211			
Multivariate Testing	Regression	.086	4	.022	1.259	.287
	Residual	3.538	207	.017		
	Total	3.624	211			

a Predictors: (Constant), Ind\_BOD

b Dependent Variable: EM

maximum value of 1 and a minimum value of 0.

Board size refers to a board's size or the number of its members. In the samples, the mean value for board size is 4.1755, with a maximum value of 11 and a minimum value of 2. Managerial ownership refers to the number of stocks owned by the company's management, board of directors, or board of commissioners. The mean value for the number of stocks owned by the company's management, board of directors, or board of commissioners is 0.018 or 1.8%, with a maximum value of 1.26 (26%) and a minimum value of 0 (0%). This indicates that basically, in the samples, the management, board of directors, or board of commissioners have a managerial ownership of 1.8%.

Board composition refers to the number of independent commissioners in comparison with the board of commissioners' total members. The mean value for the number of independent commissioners in comparison with the board of commissioners' total members is 0.3275 (32.75%),

with a maximum value of 0.67 (67%) and a minimum value of 0 (0%). 0 means a company does not have any independent commissioners, while 0.67 shows that 67% of a company's commissioners are independent.

Board tenure refers to a board's tenure in the company. The tenure will provide the board with the experience and abilities to control and supervise the company's activities. The mean value for a board of commissioners' tenure is 0.0887, with a maximum value of 0.60 and a minimum value of 0.

Board interlock refers to a board that practices interlocking directorship, that is, a board in one company also functions as a board in another. The board may be the supervisory board in one company and the management board in another. The mean value for board interlock is 0.0896 (8.96%), with a maximum value of 1 (100%) and a minimum value of 0 (0%). This indicates that basically a commissioner's involvement in another company is very small, thus they can concentrate on improving their first company's performance.

**Table 7. Multivariate Testing**

Model	Non-standardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	.064	.068		.944	.346		
Ind_BOD	-.003	.045	-.021	-.077	.939	.066	15.252
CEO_Dual	-.071	.040	-.125	-1.766	.079	.953	1.050
B_Size	.003	.017	.044	.205	.838	.103	9.721
Mgr_Own	.051	.209	.017	.246	.806	.977	1.024
B_Comp	-.015	.181	-.014	-.085	.932	.176	5.689
B_Tenr	.026	.065	.028	.403	.687	.958	1.044
B_Intr	.029	.034	.064	.876	.382	.884	1.131

a. Dependent Variable: EM

### Testing the Research's Hypotheses on Companies Listed in the Indonesian Stock Exchange During the 2004-2008 Period

The research shows that earning management practices exist in companies listed in the Indonesian Stock Exchange during the 2004-2008 period, as evinced by the significance value (0.000) which indicates these practices. The companies tend more toward income increasing than income decreasing, in the hope of attracting investors into making short-term and long-term investments.

### The Effect of Board Characteristics on Earning Management in Companies Listed in the Indonesian Stock Exchange During 2004-2008 Period

The researcher processes the data from the research on the effect of the independent board of director, dual leadership/CEO duality, board size, managerial ownership, board composition/multiple directorships, board tenure, and board interlock on earning management in companies listed in the Indonesian Stock Exchange during the 2004-2008 period. Then the data is presented in the following model summary and anova (analysis of variance) table.

### The Effect of the Independent Board of Director on Earning Management

The independent board of director's presence does not show a significant effect on earning management practices, as evinced by the significance values in Table 5 (0.858 with a correlational value of 0.012). These values indicate that independent commissioners are not yet capable of providing a significant supervision over the company's managerial activities. In general, the appointment of the independent commissioners by the company is based on the company's interests, instead of on the commissioners' personal abilities and professionalism. The commissioners' level of independence still needs further examination, especially in relation to their abilities to supervise the company's managerial activities.

Results also show that the independent commissioners are positively linked to earning management practices, with a correlational value of 0.012 or 1.2 %. The values indicate a very weak correlation between the two variables, thus independent commissioners do not significantly influence earning management practices in companies reviewed in this research.

### The Effect of Dual Leadership/CEO Duality on Earning Management

Dual leadership/CEO duality shows a significant effect on earning management practices (the significance value in Table 6 is 0.053, with a correlational value of 0.133 in Table 5). This indicates that a manager's dual role in a company opens the way to earning management practices, revealing that power concentration in a manager's hand, or the dual role, makes it possible for the manager to practice earning management, in the form of income increasing and income decreasing.

### The Effect of Board Size on Earning Management

Board size does not show a significant effect on earning management practices (the significance value in Table 6 is 0.528, with a correlational value of 0.044 in Table 5). This shows that the number of the board of commissioners' members in a company - whether there are few or many members - does not influence earning management practices. Such findings are contrary to the researches done by Xie, et al. (2003) and Chtourou, et al. (2001), which state that the more members a board of commissioners has, the more possible it is to reduce earning management practices.

### The Effect of Managerial Ownership on Earning Management

Managerial ownership does not show a significant effect on earning management practices (the significance value in Table 6 is 0.721, with a correlational value of



0.025 in Table 5). Managerial ownership represents the number of stocks owned by the company's management, board of directors, or board of commissioners. The fact of the insignificant influence is reinforced by the finding that the average percentage of stocks owned by the company's management, board of directors, or board of commissioners is 0.018 or 1.8%; thus, it can be said that the number of those stocks is insignificant in comparison with the total number of stocks in the company.

### **The Effect of Board Composition/Multiple Directorships on Earning Management**

Board composition/multiple directorships does not show a significant effect on earning management practices (the significance value in Table 6 is 0.532, with a correlational value of 0.043 in Table 5). Board composition represents the number of independent commissioners in comparison with the total number of the board of commissioners' members; they do not directly influence earning management practices. Therefore, it can be inferred that independent commissioners have not wholly contributed to good managerial activities in a company.

### **The Effect of Board Tenure on Earning Management**

Board tenure does not show a significant effect on earning management practices (the significance value in Table 6 is 0.647, with a correlational value of 0.032 in Table 5). Board tenure refers to a board's tenure in a company. The tenure will provide the board with the experience and abilities to control and supervise the company's activities; however, the experience and abilities have not significantly reduced earning management practices in the company.

### **The Effect of Board Interlock on Earning Management**

Board interlock does not show a significant effect on earning management practices (the significance value in Table 6 is 0.283, with a correlational value of 0.074 in Table 5). Board interlock refers to the existence of interlocking directorship in the company.

### **Overall Testing of the Research Variables**

Research results show that board characteristics (the independent board of director, dual leadership/CEO duality, board size, managerial ownership, board composition/multiple directorships, board tenure, and board interlock) do not significantly effect earning management in companies listed in the Indonesian Stock Exchange in the 2004-2008 period (the significance value in Table 6 is 0.632, with a correlational value of 0.158 in Table 5). Due to this evidence of insignificance, the researcher will re-test all independent variables with VIFs higher than 5, in order to prevent multi-collinearity among the independent variables.

According to Table 7, three independent variables

must be taken out as their VIFs are higher than 5: independent board of director, board size, and board composition/multiple directorships.

After all the variables are tested, the result shows that dual leadership/CEO duality, managerial ownership, board tenure, and board interlock do not significantly influence earning management in companies listed in the Indonesian Stock Exchange in the 2004-2008 period (the significance value in Table 6 is 0.287, with a correlational value of 0.154 in Table 5).

## **CONCLUSION**

Board characteristics (independent board of director, dual leadership/CEO duality, board size, managerial ownership, board composition/multiple directorships, board tenure, and audit committee) do not significantly influence earning management practices in companies listed in the Indonesian Stock Exchange in the 2004-2008 period. Only dual leadership/CEO duality has an effect on earning management practices in these companies. Therefore, audit committee needs to be added as a classification criteria for companies that use both Big Four and non-Big Four auditors. Further research on manufacturing companies is required, with a longer period of research, so that it will focus more on reviewing the independent variables that influence earning management.

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