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# THE INFLUENCES OF GOOD CORPORATE GOVERNANCE AND PROFITABILITY ON EARNINGS MANAGEMENT AT COMMERCIAL BANKS BY PANEL DATA REGRESSION ANALYSIS

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**ABSTRACT**
The company's financial statements are needed by external parties in assessing performance to obtain information related to the financial condition of a company. This financial report is processed by the management team in order to carry out earnings management to be shown to external parties by increasing or decreasing profits in order to get a good impression and obtain personal benefits. This study will be examined the effect of Good Corporate Governance (GCG) and profitability (ROA and ROE) on earnings management (discretionary accruals) from data of 16 commercial sharia and conventional banking companies in Indonesia from 2016-2020 using panel data regression analysis. The results showed that simultaneously, 11.28% of earnings management being influenced by GCG, ROA, and ROE. Only the ROA and ROE variables had a significant impact on earnings management. Based on this discussion, recommendations for further research are to add more other variables to see their effect on earnings management and compare the results when applied using other methods.

**Keywords:** Earnings Management; Good Corporate Governance; Panel Data Regression Analysis; ROA; ROE

## INTRODUCTION

In order to analyze performance and learn more about a company's financial situation, outside parties require access to the company's financial statements. The management team analyzes this financial report in order to manage earnings to be displayed to third parties by raising or lowering profits in an effort to make a positive impression and benefit personally. One of the factors influencing the company's earnings management operations is the management's introduction of suitable financial conditions. However, this conduct may spark worries that result in client fraud and obfuscated reports, including one in banking institutions. The ability of banks to conduct excellent governance in compliance with bank regulations is therefore required known as Good Corporate Governance (GCG). Good Corporate Governance refers to good corporate governance of FSI, which incorporates transparency, accountability, responsibility, independency or professionalism, and fairness principles (Financial Services Authority 2014). In order to increase share value while taking into account the interests of other stakeholders, GCG is a procedure or structure in the management process of the business (Umam, Khotibul; Utomo 2016). Additionally, profitability ratios are required to evaluate the effectiveness of financial statements in demonstrating the success of the business. This profitability can educate third parties about the company's performance, good or not. The return on equity (ROE) and return on assets (ROA) ratios can be used to calculate this profitability ratio. The ROA ratio evaluates the company's capacity to turn a profit utilizing all of its current assets after excluding capital costs (the expenses incurred to fund the assets) from the study. While ROE gauges a company's capacity to make money using particular capital stock (Utami 2017), Several studies that have been conducted previously still have gaps regarding the effect of GCG, ROA, and ROE on earnings management. For example in the research of Janrosl and Lim (2019) with Riadiani and Wahyudin (2015) which still gives different conclusions regarding the presence or absence of the influence of GCG on earnings management. The research by Damayanti and Kawedar (2018) with Putri and Machdar (2017) also provides different conclusions regarding the presence or absence of the influence of ROA on earnings management. Likewise, between research by Wowor, Morasa, and Rondonuwu (2021) with Lestari and Wulandari (2019) there is a gap regarding the presence or absence of ROE influence on earnings management. Wulandari (2021) has also conducted research on the effect of these three variables on the earnings management of six sharia bank companies in 2016–2020, which concludes that ROA and ROE have a significant effect on earnings management. Therefore, this study will continue with the previous study by adding the object of research, namely 16 sharia and conventional bank companies in 2016–2020 in Indonesia to see whether or not there is an influence of GCG, ROA, and ROE on earnings management using panel data regression analysis.

## LITERATURE REVIEW

Good Corporate Governance refers to good corporate governance of FSI, which incorporates transparency, accountability, responsibility, independency or professionalism, and fairness principles (Financial Services Authority 2014) that described as a relationship between a firm's management, directors, capital, community, and other institutions that invest their money in the company and anticipate a return on their investment. The senior management team, a group of executives in charge of managing the bank, is the main component of GCG. Both the board of directors' supervisory role and the complete control of other managers must be carried out by senior management. Decisions about strategic management must be taken by multiple managers. Profitability ratios are required to evaluate the effectiveness of financial statements in demonstrating the success of the business that can educate third parties about the company's performance, good or not. The return on equity (ROE) and return on assets (ROA) ratios can be used to calculate this profitability ratio. The ROA ratio evaluates the company's capacity to turn a profit utilizing all of its current assets after excluding capital costs (the expenses incurred to fund the assets) from the study. ROA displays the outcomes (return) on the quantity of assets utilised in a business. Since ROA is intended to determine the extent to which contributed investments may provide a respectable profit, it is frequently used as a benchmark to assess a bank's financial performance. A greater rate of return is the ultimate objective. Hence, the larger the ROA, the more strongly it will suggest that the position in the financial world will improve. While ROE gauges a company's capacity to make money using particular capital stock that describes with the ratio used to evaluate net profit after tax when using own capital (Utami 2017). The purposeful selection of an accounting method by management for a specific objective is known as earning management (Nurianah 2019). Discretionary Accrual, an atypical accrual rate resulting from management's policy to manipulate earnings as desired, serves as a proxy for earnings management (Wulandari 2022).

Several previous studies related to the relationship and influence of GCG and profitability on earnings management, including research that looked at the effect of audit committees, managerial ownership, and institutional ownership on earnings management, where these three variables had a significant effect together on earnings management, while institutional ownership has no significant effect on earnings management (Janrosl and Lim 2019). The research about ROA and ROE has a significant negative effect on earnings management (Lestari and Wulandari 2019; Putri and Machdar 2017). Research on the effect of these three variables on the earnings management of six sharia bank companies in 2016–2020, which concludes that ROA and ROE have a significant effect on earnings management (Wulandari 2022). Several applications of panel data regression analysis have been studied in various fields, including the field of food security and climate change, about population social data, educations, etc. (Affoh et al. 2022; Collier 2013; Widyaningsih and Arif 2022).

The pooling of observations on a cross-section of homes, nations, businesses, etc. over several time periods is referred to as "panel data". Effects that are simply indiscernible in pure cross-sectional or pure time-series data can be better identified and quantified using panel data (Baltagi 2005). There are several models in panel data regression analysis, including the fixed effect model, the random effect model, and the common effect model. Several tests were carried out to determine the best model of the three; these included the Chow test, the Hausman test, and the Lagrange Multiplier test (LM test). The Chow test was used to determine the model between H0: Common Effect model and H1: Fixed Effect model. The Hausman test is used to determine the model between H0: Random Effect model and H1: Fixed Effect model, while the LM test is used to determine the model between H0: Common Effect model and H1: Random Effect model. If we are concentrating on a specific group of N firms, the fixed effects model is a suitable formulation. If we are randomly selecting N item from a big population, the random effects model is a suitable specification. The panel is carefully created to be "representative" of the population from whom we are aiming to draw conclusions. N is typically big in this situation, and a fixed effects model would result in a significant loss of degrees of freedom. According to the definition of the individual effect, it is random, and the inference is made about the population from which the sample was randomly selected. (Baltagi 2005). In Common Effect model is not considered time and individual dimensions, so it is assumed that the behavior of c use the Ordinary Least Square (OLS) approach or the least squares technique to estimate the panel data model (Zulfikar 2018). As in linear regression analysis, the effect of independent variables on the dependent variable together can be known through the F test simultaneously, while the effect of each independent variable on the dependent variable can be known through the t test partially. To find out the goodness of the selected model, it can be used through the adjusted R-Square value.

## METHODS

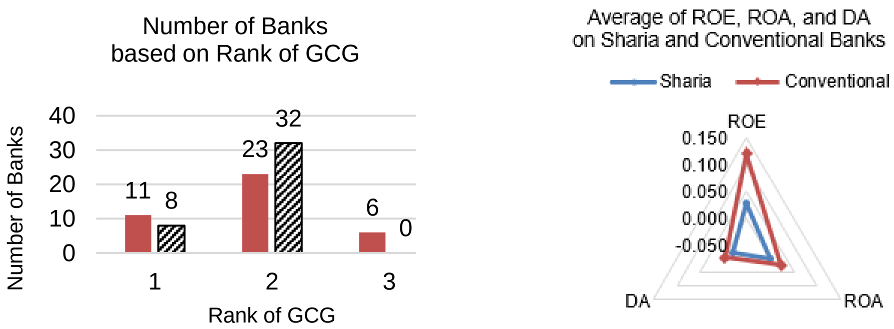
The data that will be used in this study is secondary data from 16 conventional banks and sharia banks registered with the Otoritas Jasa Keuangan (OJK). The variables used in this study include the GCG, ROA, and ROE variables as independent variables, and discretionary accruals (DA) as the dependent variable, obtained from the 2016-2020 annual reports of each bank. The analytical methods that will be used in this research are descriptive analysis to see a general summary of the data used and panel data regression analysis to see whether or not there is an influence of GCG, ROA, and ROE on earnings management (DA). The statistical tools used in this analysis will use the help of the RStudio program. The stages of analysis that will be carried out are as follows:

a. Pre-processing data
b. Conduct descriptive analysis to see a general summary of the data
c. Data standardization
d. Perform panel data regression analysis to see the effect of GCG, ROA, and ROE variables on DA
e. Perform Chow test, Hausman test, and Lagrange Multiplier test to see the best model
f. Determining the panel data regression model
g. Model output interpretation
h. Draw a conclusion

## RESULTS

Before conducting inferential analysis, descriptive analysis was first carried out to see a general summary of the data used. This data consists of 80 objects from 16 for each conventional and sharia banks in 2016-2020 in Indonesia that are registered with the OJK.

**Figure 1. Descriptive Analysis**



Based on Figure 1. above, as many as 80 banks studied consisted of 8 banks each, both conventional banks and sharia banks in Indonesia in 2016-2020, there were 55 banks that were ranked 2nd regarding their GCG, consists of 23 sharia banks and 32 conventional banks. Of those, 19 banks were ranked 1st, and six others were ranked 3rd. Based on radar chart on the right, the average of ROE, ROA, and DA on conventional banks greater than sharia banks, as can be seen from the nets on the radar chart for conventional bank data, which are outside for these three variables compared to sharia banks. After the descriptive analysis has been carried out, the next step is to standardize the data before proceeding to the panel data regression analysis stage.

**Table 1. Best Model Determination**

| Test | Hypothesis | F-stat (p-value) | Selected Model |
|---|---|---|---|
| Chow Test | $H_0$: Common Effect Model<br>$H_1$: Fixed Effect Model | 2.88 (.00**) | Fixed Effect Model |
| Hausman Test | $H_0$: Random Effect Model<br>$H_1$: Fixed Effect Model | 7.42 (.06) | Random Effect Model |
| LM Test | $H_0$: Common Effect Model<br>$H_1$: Random Effect Model | 5.24 (.07) | Common Effect Model |

Note. **p-value < .05

After standardizing the data, the next step is panel data regression analysis. To determine the best model from the results of panel data regression analysis, the Chow test, Hausman test, and LM test were carried out, so that the best model was chosen, the Common Effect model. The following are the results of the test statistics from the Common Effect model, which can be seen in Table 2.

**Table 2. Common Effect of Panel Data Regression Results**

| | Estimate | Std.Error | t-value | p-value |
|---|---|---|---|---|
| (Intercept) | -6.6052e-17 | 1.0531e-01 | .0000 | 1.0000 |
| GCG | .00433 | .01177 | 0.3675 | .7142822 |
| ROA | .05864 | .01690 | 3.4696 | .0008623** |
| ROE | .05394 | .01691 | -3.1895 | .0020711** |
| F-stat (p-value) | 4.35 (.0070) | | | |
| Adjusted R-Square | .11276 | | | |

Note. **p-value < .05

Based on Table 2, it can be seen that simultaneously, the results of the F test with an F-stat value of 4.35 and a p-value of .0070 < .05, can be concluded that together the GCG, ROA, and ROE variables have a significant effect on DA. Furthermore, to see the effect of each variable on DA, it can be seen through a partial test using the results of the t-value where, among the three independent variables, the ROA and ROE variables have a positive and significant effect on DA because each has a p-value < .05, while the GCG variable has no significant effect on DA. The diversity of the three variables in describing DA is 11.28%, as seen from the adjusted R-Square value. The remaining 88.72% can be explained by other variables outside the model. The coefficient value for the ROA variable is .05864, meaning that every one unit increase in ROA will increase DA by .05864, as well as the ROE variable, where every one unit increase in ROE value will increase DA by .05394.

## DISCUSSION

Simultaneously, GCG, ROE, and ROA have a significant effect on earnings management, although when viewed partially, only ROE and ROA have a positive and significant effect on earnings management. Of the three variables used in this study, the diversity in explaining earnings management in the model is still 11.28%. This still needs the addition of other variables to be investigated to see its effect on earnings management. However, the results obtained in this study strengthen the results of previous studies that GCG has no significant effect on earnings management, while ROE and ROA have a significant effect on earnings management (Janrosl and Lim 2019; Lestari and Wulandari 2019; Putri and Machdar 2017; Wulandari 2022). Based on the result, there is no discernible impact of GCG mechanisms on financial performance. According to the study's findings, the company's numerous commissioners do not yet offer adequate management oversight in an effort to raise productivity. There is a chance that the independent commissioner's position may help to reduce any agency problems that may develop between the board of directors and the shareholders. An independent board of commissioners can carry out its duties to supervise the board of directors' performance and ensure that the results are in the best interests of shareholders (Mahrani and Soewarno 2018). The ROE and ROA variables in this study have a positive and significant effect on earnings management. This is in accordance with the statement that the greater the ROA figure, the greater the company's potential for profit, because a high ROA gives business managers the ability to manage earnings by boosting profits to receive hefty bonuses (Rusdianto; Narsa 2020).

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## CONCLUSION

Based on the previous discussion, it can be concluded that together, GCG, ROA, and ROE have a significant effect on earnings management. Partially, only ROE and ROA have a positive and significant effect on earnings management. The diversity of DA in describing earnings management based on GCG, ROE, and ROA can be explained by 11.28%, while the rest is explained by other variables outside the model. This needs to be a recommendation for further researchers to add more other variables to see their effect on earnings management and compare the results when applied using other methods.

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