



The Effects of Corporate Governance, Managerial Ownership and Bonus Plan on Earnings Management: A Case of ASEAN-3 Companies

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ABSTRACT

This study is to examine and analyze the effects of corporate governance, managerial ownership, and bonus plan on earnings management of manufacturing and financial companies, which are listed on the Indonesia Stock Exchange, Malaysia Stock Exchange, and the Philippines Stock Exchange. It analyzed the balance sheet data, income, and capital statements presented in the 2008-2012 periods and applied the multiple linear regression analysis and one-way ANOVA to test the proposed hypotheses. The findings showed that corporate governance, managerial ownership, and bonus plan simultaneously did not affect earnings management. There was no significant difference in the proportion of independent board of commissioners, the size of the board of directors, proportion of independent audit committee, managerial ownership, bonus plan, and earnings management between Indonesia, Malaysia, and the Philippines stock exchanges. It implies that the ASEAN-3 companies consider corporate governance unimportant in managing their earnings. It also gives new insights into a rare phenomenon of agency theory findings in semi-strong market efficiency post-global financial crisis 2008.

Keywords: Earnings Management, Corporate Governance, Managerial Ownership, Bonus Plan

1. Introduction

Financial statements are one of the primary sources of financial information that is important for several users in making economic decisions. One element of financial statement information that attracts attention is information about company profits. Earnings reports produced by company managers are inseparable from selecting accounting policies for a particular purpose, known as earnings management (Scott, 2008).

There is a tendency for managers to engage in opportunistic behavior in the form of earnings management. Managers' opportunistic behavior arises because of differences in conflicts of interest between managers and shareholders (Holthausen, 1990). Earnings management occurs when company managers use judgment in financial reporting and the preparation of transactions that can change financial statements (Perols and Lougee, 2011). This information can mislead shareholders and affect contractual results that rely on reported accounting numbers (Prior et. al., 2008). Investors become distrustful of the financial quality presented, increasing interest in the factors determining earnings management. Therefore, this study will examine the factors that affect earnings management.

Earnings management can be minimized by implementing Good Corporate Governance (GCG) mechanisms (Cornett et. al., 2009). Companies use good corporate governance to limit information asymmetry problems that often encourage earnings management (Cohen, 2002). A good corporate governance mechanism can be implemented by establishing a board of dependent commissioners and an audit committee (Nelson and Shukeri, 2011). The board of commissioners ensures the implementation of corporate strategy, oversees

management in managing the company, and requires accountability ([Mahrani and Soewarno, 2018](#)). Meanwhile, the audit committee is an effort to improve the management and supervision of the company ([Xie et. al., 2003](#)).

Another factor that can be used to reduce the occurrence of conflicts of interest is managerial ownership. The ownership of company shares by management can equalize the interests of managers and shareholders ([Cullinan et. al., 2012](#)). These decisions will affect his position as a company manager and shareholder. Therefore, managerial ownership will increase investor confidence that the behavior of managers to take actions to manipulate earnings can be minimized.

In addition to managerial ownership, compensation in the form of bonuses can be used to balance the interests of managers and shareholders ([Bergstresser and Philippon, 2006](#)). This incentive is based on research examining the relationship between bonuses and the selection of accounting policies ([Prihastomo and Khafid, 2018](#)) ([Hassen, 2014](#)). Prior studies ([Demsetz and Villalonga, 2001](#)) found that managers in America use earnings management to maximize bonuses received.

Based on previous theory and empirical findings, this study will examine the effect of three factors: good corporate governance, managerial ownership, and bonus plans on earnings management. There is still a research gap among researchers regarding the influence of these three factors on earnings management. According to reference ([Peasnell et. al., 2005](#)), the existence of an independent commissioner effectively limits the management of earnings management. However, another research found that firms with a high proportion of independent commissioners were not associated with lower levels of earnings management ([Lai, 2005](#)). Prior findings ([Ross et. al., 2009](#)) said that the greater the proportion of management ownership in the company, the more the management tends to try harder to maximize the interests of shareholders, including himself. However, according to ([Yu, 2008](#)), if the management carried out by the company's management is opportunistic, high managerial ownership will increase earnings management. Therefore, this study will fill the existing research gap by ascertaining the effect of good corporate governance, managerial ownership, and bonus plans on earnings management.

Apart from focusing on the Indonesia Stock Exchange, this research also focuses on the Malaysia Stock Exchange and the Philippines Stock Exchange, considering that the two countries are both closest and directly adjacent to Indonesia. According to the principles of economic integration, it is estimated that economic and financial events occurring in one country will propagate and affect the economic and financial conditions of the other two countries. This study also examines differences in the proportion of independent commissioners, the board size, presence/proportion of independent audit committees, managerial ownership, bonus plans, and earnings management between Indonesia, Malaysia, and the Philippines Stock Exchange. This research provides an essential contribution for companies to implement and apply good corporate governance, managerial ownership, and bonus schemes to minimize the use of earnings management in achieving reliable quality financial information.

2. Method

2.1. Research Model

Earnings management is a controversial and important area in financial accounting. Earnings management occurs when managers use judgment in financial reporting and preparation of transactions to modify financial statements, manipulate the magnitude of earnings, or influence the outcome of contracts that depend on reported accounting numbers ([Healy and Wahlen, 1999](#)). This practice occurs when management access information that is not accessible to outsiders ([Richardson, 2000](#)). Earnings management is not always interpreted as a negative effort that is detrimental because earnings management is not always oriented to earnings manipulation ([Rahman and Ali, 2006](#)). Earnings management is more likely to be associated with the choice of accounting methods that are deliberately chosen by management for specific purposes within GAAP constraints ([Beneish, 2001](#)).

To minimize earning management, companies can apply good corporate governance mechanisms. The board of commissioners plays an essential role in the mechanism of good corporate governance, especially in monitoring top-level managers, selecting senior executives ([Ruigrok et. al., 2006](#)), and conducting transparency of executive salaries ([Liu and Taylor, 2008](#)). The board of commissioners is effective in protecting the prosperity of shareholders when the proportion of independent commissioners is greater. This

mechanism is because the independent board of commissioners is not influenced by management and opportunistic behavior ([Wimelda and Chandra, 2018](#)).

Furthermore, much of the literature emphasizes the importance of board size in monitoring firm managers and reducing agency conflicts between managers and shareholders, as well as conflicts between managers and bondholders. Prior studies ([Yermack, 1996](#)), documented shareholder preference for smaller boards due to the inverse relationship between board size and corporate performance. Although shareholders appear to prefer smaller boards due to better company performance, lenders may prefer larger boards because of potentially greater monitoring capabilities and less shareholder power ([Hermalin and Weisbach, 2001](#)).

In the context of monitoring actions, bondholders consider the effectiveness of the independent audit committee's supervision as a source of assurance for the integrity of the values in the financial statements ([Bacha, 2019](#)). The existence of an independent audit committee is expected to balance the decision-making of the board of commissioners ([Permatasari et. al., 2019](#)). Previous research shows that the larger the independent audit committee, the smaller the company's cost of debt ([Anderson et. al., 2004](#)).

Earning management can also be minimized by managerial ownership ([Susanto and Pradipta, 2016](#)). Managerial ownership is thriving as a mechanism to reduce managers' agency problems by aligning managers' interests with shareholders ([Lafond and Roychowdhury, 2008](#)). The interests of managers and external shareholders can be united if the share ownership by managers is enlarged so that managers will not manipulate earnings for their interests ([Richardson, 2000](#)). Low managerial ownership increases the incentive for opportunistic behavior ([Warfield et. al., 1995](#)).

Next is the provision of compensation as a way to align the interests of managers with company owners. The literature on incentive compensation documents that managers use discretionary accruals to manage earnings to achieve their bonus levels ([Cheng and Warfield, 2005](#)) and increase the value of stock options ([Baker et. al., 2011](#)). However, the reference finds that companies that reduce contract incentives to manage earnings reduce but do not fully mitigate earnings management behavior ([Carter et. al., 2005](#)).

Based on the theoretical description and the findings of previous studies above, it can be assumed that the proportion of independent commissioners, the size of the board of directors, the presence/proportion of independent audit committees, managerial ownership, and bonus plans collectively affect earnings management. Therefore, the research model is depicted in Figure 1.

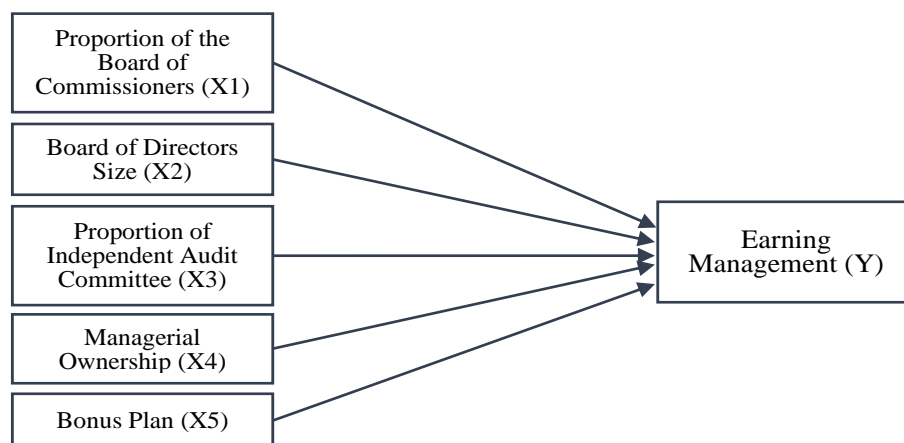


Figure 1. Research model

This study also aims to analyze and test whether there are differences in the proportion of independent commissioners, the board size, presence/proportion of independent audit committees, managerial ownership, bonus plans, and earnings management between the ASEAN-3 stock exchanges. Thus the hypothesis of this research is as follows:

H1: The proportion of independent commissioners, the size of the board of directors, the presence/proportion of an independent audit committee, managerial ownership, and bonus plans have a significant effect on earnings management simultaneously.

H2: There is a difference in the proportion of independent commissioners, board of directors size, presence/proportion of independent audit committees, managerial ownership, bonus plans, and earnings management between the Indonesia Stock Exchange and the Malaysia Stock Exchange.

H3: There is a difference in the proportion of independent commissioners, size of the board of directors, presence/proportion of independent audit committees, managerial ownership, bonus plans, and earnings management between the Indonesia Stock Exchange and the Philippines Stock Exchange.

H4: There is a difference in the proportion of independent commissioners, size of the board of directors, presence/proportion of independent audit committees, managerial ownership, bonus plans, and earnings management between the Malaysia Stock Exchange and the Philippines Stock Exchange.

2.2. Methodological Approach

The unit of analysis in this study is a publicly listed company in the manufacturing and finance/banking industries on Indonesia, Malaysia, and the Philippines Stock Exchanges. Those industries were chosen because it is the sector with the most issuers so that they can represent the population of stock exchange issuers as a whole. The data is taken from the Indonesia Stock Exchange, Malaysia Stock Exchange, and the Philippines Stock Exchange in the form of balance sheet data, income statements, and reports of changes in equity presented in the 2008-2012 financial statements. The dependent variable in this research model is earnings management. The Discretionary Accrual Modified Jones Model measures earnings management. The selection of this model is considered the best model for detecting the existence of earnings management practices than other models ([Dechow et. al., 1996](#)). There are four steps to calculate earnings management with the Discretionary Accrual Modified Jones Model. The first step is to calculate the total accruals with the following formula:

$$TACC_t = NI_t - CFO_t$$

$TACC_t$ = Total company accruals

NI_t = Company's total net profit

CFO_t = Total cash from the company's operating activities

The Total Accrual value obtained is then estimated using the Ordinary Square Least regression equation as follows:

$$TACC_t/TA_{t-1} = \beta_1(1/TA_{t-1}) + \beta_2\{(\Delta SAL_t - \Delta REC_t)/TA_{t-1}\} + \beta_3(PPE_t/TA_{t-1}) + e$$

$TACC_t$ = Total company accruals

TA_{t-1} = Total company assets

ΔSAL_t = Change in the company's net sales in period t

ΔREC_t = Change in the company's net accounts receivable in period t

PPE_t = Property, plant, and equipment of the company in period t

$\beta_1, \beta_2, \beta_3$ = Regression coefficient

By using the regression coefficient above, the value of Non-Discretionary Accruals can be calculated by the formula:

$$NDAC_t = \hat{\alpha}_1(1/TA_{t-1}) + \hat{\alpha}_2\{(\Delta SAL_t - \Delta REC_t)/TA_{t-1}\} + \hat{\alpha}_3(PPE_t/TA_{t-1})$$

$NDAC_t$ = Company's non-discretionary accruals

TA_{t-1} = Total company assets

ΔSAL_t = Change in the company's net sales in period t

ΔREC_t = Change in the company's net accounts receivable in period t

PPE_t = Property, plant, and equipment of the company in period t

$\hat{\alpha}_1, \hat{\alpha}_2, \hat{\alpha}_3$ = Regression coefficient

The value of discretionary accruals is obtained by subtracting the total value of accruals from the value of non-discretionary accruals so that the formula for calculating discretionary accruals is:

$$DAC_t = (TACC_t/TA_{t-1}) - NDAC_t$$

DAC_t = Company's discretionary accruals
 $TACC_t$ = Total company accruals
 TA_{t-1} = Total company assets
 $NDAC_t$ = Total company's non-discretionary accruals

The independent variables in this study are the proportion of the independent board of commissioners, the size of the board of directors, the existence/proportion of the independent audit committee, managerial ownership, and the bonus plan. The proportion of the Independent Board of Commissioners is the percentage of the number of independent commissioners to the total number of members of the board of commissioners. The size of the board of directors is the number of members of the board of directors in the company, using a ratio scale. The audit committee, in this case, is a dummy variable. Companies with an audit committee in the company's financial statements are given a value of 1 and 0 for companies that do not have an audit committee present. Then the indicator used for managerial ownership is the percentage of the number of shares owned by the management of the company's total share capital. The last independent variable is the bonus plan. A bonus plan is a compensation program in the form of bonuses the company provides to employees for their achievements in achieving company goals. The workforce in question is the board of commissioners and directors.

The data analysis technique used is the multiple linear regression method with the help of Software SPSS version 20. Previously, the data must first meet the classical assumption test. Before the regression test, the data must first meet the classical assumption test. The classical assumption test used is the normality test with Kolmogorov Smirnov, the heteroscedasticity test with the Glejser test, and the multicollinearity test with tolerance and Variance Inflation Factor (VIF) values.

3. Result and Discussion

3.1. Result

Descriptive statistical analysis was used to describe the variables in the study. Descriptive statistics will provide an overview or description of data seen from the minimum value, maximum value, average value (mean), and standard deviation value. The results of descriptive statistics are shown in Table 1.

Table 1. Descriptive statistics

Variable	Minimum	Maximum	Mean	Std. Deviation
The proportion of the Board of Commissioners	0.00	1.00	0.4057	0.11730
Board of Directors Size	1.00	13.00	4.9930	1.89905
The proportion of Independent Audit Committee	0.00	1.00	0.6571	0.15296
Managerial Ownership	0.00	30.00	0.0719	1.12457
Bonus Plan	8587804.00	297700000000	14188327817	26099727672
Earnings Management	-3.54	11.94	1.3611	1.59945

The data normality test aims to determine whether the data is normally distributed. Based on Table 2, it can be seen that the significance value for all variables is $0.00 < 0.05$. So, it can be concluded that all research data are not normally distributed. Then the results of the multicollinearity test (Table 3), show that the VIF value of all variables is less than 10, which indicates the absence of multicollinearity symptoms. The last classic assumption test is the heteroscedasticity test. Table 3 shows that the significance value obtained by all independent variables to the absolute residual value of earnings management is > 0.05 . So, it can be said that there is no symptom of heteroscedasticity

Table 2. Normality test

No	Null Hypothesis	Test	Sig.	Decision
1	The distribution of the Proportion of the Board of Commissioners is normal	One-Sample Kolmogorov-Smirnov Test	0.000	Reject the null hypothesis
2	The categories of Board of Directors Size occur with equal probabilities	One-Sample Chi-Square Test	0.000	Reject the null hypothesis
3	The distribution of the Proportion of the Independent Audit Committee is normal	One-Sample Kolmogorov-Smirnov Test	0.000	Reject the null hypothesis
4	The distribution of Managerial Ownership is normal	One-Sample Kolmogorov-Smirnov Test	0.000	Reject the null hypothesis
5	The distribution of the Bonus Plan is normal	One-Sample Kolmogorov-Smirnov Test	0.000	Reject the null hypothesis
6	The distribution of Earnings Management is normal	One-Sample Kolmogorov-Smirnov Test	0.000	Reject the null hypothesis

Table 3. Multicollinearity and heteroscedasticity test

Variable	Multicollinearity Test		Heteroskedasticity Test	
	Tolerance	VIF	T-Statistics	Sig.
The proportion of the Board of Commissioners	0.986	1.015	1.231	0.220
Board of Directors Size	0.903	1.107	0.249	0.804
The proportion of Independent Audit Committee	0.983	1.018	-0.448	0.655
Managerial Ownership	0.993	1.007	-0.277	0.782
Bonus Plan	0.906	1.104	-1.378	0.170

F-test tests the relationship between more than one independent variable and one other dependent variable (simultaneous test). Multiple linear regression equation analysis was used in this study to determine the effect of one and more independent variables simultaneously on the dependent variable. Based on Table 4, the F test shows that the significance level is $0.918 > 0.05$, so the proportion of the independent board of commissioners, the size of the board of directors, the proportion of the independent audit committee, managerial ownership, and the bonus plan have no significant effect on earnings management simultaneously. Then, based on table 5, it can be identified that the proportion of the independent board of commissioners, the size of the board of directors, the proportion of the independent audit committee, managerial ownership, and bonus plan partially also have no significant effect on earnings management, because the significance value of all variables is > 0.05 .

Table 4. F test

	Sum of Squares	df	Mean Square	F	Sig.
Regression	3.261	5	0.652	0.289	0.918
Residual	307.122	136	2.258		
Total	310.383	141			

Table 5. Regression test results

Model	Unstandardized Coefficient		Standardized Coefficient Beta	t	Sig.
	B	Std. Error			
(Constant)	2.111	0.768		2.749	0.007
The proportion of the Board of Commissioners	-0.948	1.000	-0.082	-0.948	0.345
Board of Directors Size	-0.026	0.074	-0.032	-0.355	0.723
The proportion of Independent Audit Committee	0.180	0.793	-0.020	-0.227	0.821
Managerial Ownership	1.401	2.481	0.049	0.565	0.573
Bonus Plan	-1.272E-13	0.000	-0.002	-0.026	0.979

One Way ANOVA test is used to examine the differences in the proportion of Independent Commissioners, Board of Directors Size, Independent Audit Committee Proportion, Managerial Ownership, Bonus Plan, and Earnings Management between Indonesia, Malaysia, and the Philippines Stock Exchanges. Based on Table 6, the significance value of the three ANOVA tests is > 0.05 . So, it can be concluded that there is no difference in the proportion of Independent Commissioners, Board of Directors Size, Independent Audit Committee Proportion, Managerial Ownership, Bonus Plan, and Earnings Management between the Indonesia and Malaysia Stock Exchanges, Indonesia and Philippines Stock Exchanges, and Malaysia and Philippines Stock Exchanges.

Table 6. ANOVA test results

	Sum of Squares	df	Mean Square	F	Sig.
Indonesia and Malaysia					
Between Groups	1234880205651207300000	1	1234880205651207300000	1.561	0.212
Within Groups	449257478766689600000000	568	790946265434312700000		
Total	450492358972340750000000	569			
Indonesia and Philippines					
Between Groups	451709907437331300000	1	451709907437331300000	0.561	0.454
Within Groups	358407313221941660000000	445	805409692633576800000		
Total	358859023129379000000000	446			
Malaysia and Philippines					
Between Groups	62155982223301270000	1	62155982223301270000	0.157	0.692
Within Groups	164248299266185170000000	415	395779034376349800000		
Total	164310455248408500000000	416			

3.2. Discussion

The results of this study are inconsistent with the opinions of experts. According to (Ruigrok et. al., 2006), the board of commissioners plays an essential role in a good corporate governance mechanism, especially in monitoring top-level managers and selecting senior executives. The size of the board is a factor in monitoring company managers and reducing agency conflicts between managers and shareholders and between managers and bondholders (Yermack, 1996). The opinion (Vance, 1983) regarding the role of an independent committee and financial experts on the executive committee can provide valuable monitoring in limiting earnings management actions.

The results of this study are also inconsistent with the findings of related studies. In a study of the relationship between firm value and board structure, (Coles et. al., 2008) found that for larger firms, it is optimal to have more external directors. The study Mansor et. al. (2013) found that the total sample companies as a whole, the independence of the board, the independence of the internal audit function, and the size of the company are corporate governance mechanisms that can help in overcoming the problem of earnings management. Previous research concluded that companies with a proportion of members of the board of commissioners who come from outside the company or directors could influence earnings management actions (Dechow et.al., 1996).

This study did not find significant differences in the proportion of independent commissioners, size of the board of directors, the proportion of independent audit committees, managerial ownership, bonus plans, and earnings management between Indonesia, Malaysia, and the Philippines stock exchanges. These results do not support the findings (Farida et. al., 2010) that implementing corporate governance in Indonesian banking companies significantly affects the managerial ownership proxy. However, the results of this study are consistent with the findings (Mansor et. al., 2013). From the corporate governance mechanism, only the number of visitors was found to be significantly negatively related to the earnings management of family firms in Malaysia. Prior studies (Hwang et. al., 2008), which examined the mechanisms of good corporate governance in companies in the Philippines, also refuted the results of this study. It showed that shareholder demand for conservatism aims to mitigate litigation, taxation, and regulatory costs for companies that reinforce traditional agency theory as the dominant principle driving management decisions.

4. Conclusion

This study cannot prove all the hypotheses proposed. The proportion of independent board of commissioners, size of the board of directors, the proportion of independent audit committee, managerial ownership, and bonus plan partially and simultaneously have no significant effect on earnings management. In addition, this study did not find any significant difference in the independent board of commissioners, size of the board of directors, the proportion of independent audit committee, managerial ownership, and bonuses between the stock exchanges of Indonesia, Malaysia, and the Philippines. The results of this study emphasize that financial statement analysis and corporate governance are essential for investors and corporate financial managers as the basis for making their business decisions. However, it is not the only consideration used because the results of this study prove that corporate governance has no significant effect on earnings management. For future researchers, this research can be developed using a more extended observation period, for example, ten years or 20 years, to have more comprehensive data strength and research results to compare with similar studies.

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