
Determinants of Earning Management at Indonesia's Coal Mining Companies

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ABSTRACT

This study analyzes the determinant of earning management based on profitability, firm size, institutional ownership, and audit committee on Indonesia's mining sector companies. This study uses panel data from the 2014-2019 financial report of 9 mining companies listed on the Indonesia Stock Exchange (IDX). The sample is determined by the purposive method, which resulted in 54 observations data. Using the common effect model (CEM) panel data analysis, this study has revealed that firm size and audit committee has a negative, but institutional ownership has a positive effect on earning management. Besides, profitability does not affect earning management. This study implies that companies need to improve their monitoring quality by adding more audit committee to reduce the earning management. The government is expected to facilitate the role of institutional investors so that they can be more optimal in the aspect of supervision, not just profit orientation. Future studies are expected to increase the number of data observations, variables, and more method to obtain the robustness result about earning management determinants.

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1. INTRODUCTION

For the last two decades, management earnings practices have been getting more highlight by accounting researchers (Gao & Gao, 2016). The intense concern is due to the ongoing accounting scandals involving earning management practice worldwide. Indonesia is also facing this issue, marked by the PT Garuda Indonesia scandal in 2018, also another scandal experienced by PT Jiwasraya. Further, the potential of earnings management tends to

escalate due to the rapid intensity of business competition due to the pandemic. Accordingly, competition has become one of the motives for earnings management to occur (Remenarić et al., 2018).

The high intensity of competition also appears among coal mining companies in Indonesia. The rivalry is marked by the escalation in coal demand, especially from China. Nevertheless, the fluctuating price of coal triggers the stock market price volatility of coal stock issuers. Therefore, the potential investors need to remain vigilant by observing the earnings management risks of the issuers experiencing the stock price escalation (Market Bisnis, 2021). Accordingly, understanding the determinants of earnings management is essential for the coal mining industry. Additionally, the possibility of earnings management to cause misleading towards the financial report users has proven that the issue might decrease companies' profitability (Anjum et al., 2012).

Researches conducted by Lestari & Wulandari (2019), Purnama (2017), Aljana & Purwanto (2017), Suaidah & Utomo (2018), Basir & Muslih (2019), Giovani (2019), Febriarti (2017), Tala & Karamory (2017), and Yanti & Ery Setiawan (2019) succeeded to prove the positive effect of profitability on earnings management. On the other hand, other research results have different findings, such as Fahmie (2018) and Kapoor & Goel (2017) that found a negative effect of profitability on earnings management. Additionally, researches by Agustia & Suryani (2018), Amelia & Hernawati (2016), and Gunawan et al. (2015) could not prove that profitability had any effect on earnings management. Consequently, there have been debates on profitability's effect in triggering earnings management and whether or not the high profitability will prevent a particular company from experiencing earnings management.

In addition to profitability, another financial characteristic that presumably correlates in causing earning management is the firm size. Research by Gunawan et al. (2015), Medyawati & Dayanti (2016), Lisboa (2016), and Lubis & Suryani (2018) proved that firm size had a positive effect on earnings management. The finding is supported by agency theory stating that the bigger a company is, the higher the agency cost will be, leading to opportunistic practices, primarily related to managerial bonuses (Jensen & Meckling, 1976). In addition, when a company gets bigger, its operational scope will become more extensive, leading to asymmetrical information issues.

Apart from the findings mentioned earlier, some research found the negative effect of firm size on earnings management. Some of the research are conducted by Santi & Wardani (2018), Prasetya & Gayatri (2016), Jao & Pagalung (2011), Taco & Ilat (2016), Arthawan &

Wirasedana (2018), Swastika (2013), Sirat (2012), and Ahmad et al. (2014). However, the fundamental logic of the empirical findings on the mentioned research is relatively factual, indicating company profit follows the firm size; consequently, the management will reduce the profit to avoid high tax. Accordingly, there has been debate on the effect of firm size on earnings management results, increasing or reducing the risk.

Referring to agency theory from Jensen & Meckling (1976), one of the attempts to anticipate the agency problems is by using ownership structure. Institutional ownership has become an attempt to increase the shareholders monitoring towards agents to avoid earnings management and other corruptive practices. Researches by Sofia & Murwaningsari (2019), Sirat (2012), Osta (2011), and Sumanto et al. (2014) found the negative effect of institutional ownership on earnings management. Meanwhile, research by Al-Fayoumi et al. (2010), D. Agustia (2013), Siregar (2017), and Nuryana & Surjandari (2019) failed to prove the correlation between institutional ownership on earnings management.

Another research from Handayani & Wksuana (2020), Setiawati & Lieany (2016), and Jao & Pagalung (2011), on the contrary, found a positive effect of institutional ownership on earnings management. Research (Jao & Pagalung, 2011) employed an argument by Potter (1992) as the basis to propose that institutional investors focused more on current earnings and failed to serve adequate monitoring; thus, the directors incited to initiate earnings management. Besides, there is a tendency from the management to achieve targeted profit from the institutional investors; thus, it urges the earnings management practices.

The number of institutional ownership needs to be in line with the enhancement of the audit committee. Some researches by Alzoubi (2019), Isa & Farouk (2018), Umar & Hassan (2018), Waweru (2018), Agyei-Mensah & Yeboah (2019), Daoud (2018), and Albersmann & Hohenfels (2017) were succeeded to prove that the audit committee can reduce the level of earnings management. Nevertheless, some researches failed to find the correlation between the audit committee and earnings management; some of the researches are Nugroho & Eko (2011), Juhmani (2017), Qamhan et al. (2018), Iriyadi (2019), and Muda et al. (2018). Further, Al-Absy et al. (2020) proved that the audit committee having the chief of board's involvement could surprisingly increase the potential of earnings management.

A variety of research results has become the main motive in conducting this research. The primary purpose of this research is to validate the earnings management determinants in Indonesian coal mining companies based on the company's financial characteristics and corporate governance aspects. The financial characteristics are represented by profitability and firm size, while the corporate governance is by institutional ownership and audit

committee. Therefore, this research is expected to find dominant variables that affect earnings management in Indonesian coal mining companies.

Theoretical Framework and Hypothesis Development

Earnings management is a strategy of a company to deliberately manipulate its accruals by exploiting the flexibility of accounting regulation to temporarily improve its financial performance (Dechow & Skinner, 2000). Both theoretically and practically, there is much evidence that managers tend to improve the current year earnings by flattening out the incoming year earnings (Gao & Gao, 2016). According to Gao & Gao (2016), earnings management has two definitions: accruals-based management and real earnings management. The most common motives for earnings management are to achieve earning target bonus for the management, to increase the company's image in attracting the investors, and to answer the rivalry in achieving funding.

Accounting researchers employ the company's financial performance characteristics as a significant determinant of earning management. Profitability, for example, has been proven to have effects on earnings management. Nevertheless, the impact varies due to the different measurement proxy of the earnings management itself (Gao & Gao, 2016). According to Lestari & Wulandari (2019), Purnama (2017), Aljana & Purwanto (2017), Suaidah & Utomo (2018), Basir & Muslih (2019), Giovani (2019), Febriarti (2017), Tala & Karamory (2017), and Yanti & Ery Setiawan (2019), profitability has a positive effect on earnings management. Further, one strategy of earnings management to respond to high profitability is to decrease the earning value, anticipate any political effect, and carry taxation motive at the same time (Scott & others, 1997).

Other research by Fahmie (2018) and Kapoor & Goel (2017) proposed that profitability negatively affected earnings management. Thus, high profitability causes shareholders to perform rigid monitoring, and simultaneously, the regulator is deemed to escalate, resulting in the reduction in earnings management. Meanwhile, research by Agustia & Suryani (2018), Amelia & Hernawati (2016), and Gunawan et al. (2015) could not prove the correlation between profitability and earnings management. Therefore, despite the studies different results on the correlation between profitability and earnings management, this research proposes the following hypothesis:

H1: Profitability positively affects earnings management

One of the main causes of the emergence of earnings management is information asymmetry. According to Sehar et al. (2013), the firm size directly proportional to the

information asymmetry. Furthermore, based on agency theory from Jensen & Meckling (1976), the appearance of information asymmetry and other agency problems can cause the emergence of opportunistic practices, including earnings management concerning managerial bonuses. Thus, the manager(s) will achieve a higher bonus upon reaching a particular level of the company's earnings. Therefore, firm size is considered to increase the potential of earnings management. Furthermore, some research by Gunawan et al. (2015), Medyawati & Dayanti (2016), Lisboa (2016), and Lubis & Suryani (2018) suggested that firm size positively affects earnings management. For example, Lisboa (2016) stated that the company's size directly proportional to the earnings management level in terms of cost of goods sold and production cost, as the company tends to address the investors' expectation, especially during the crisis.

However, on the other hand, the big-sized company can have a more efficient control system that eventually leads to the reduction of earnings management (Watts & Zimmerman, 1986). Moreover, some studies proved company size had a negative effect on earnings management; such as research by Santi & Wardani (2018), Prasetya & Gayatri (2016), Jao & Pagalung (2011), Taco & Ilat (2016), Arthawan & Wirasedana (2018), Swastika (2013), Sirat (2012), and Ahmad et al. (2014). Most of those findings proposed that earnings management would reduce the profit/ earning value to avoid high tax. Based on the two arguments, this study proposes the following hypothesis:

H2 : Firm size positively affects earnings management.

In addition to financial performance, some researchers employed corporate governance as the determinant of earnings management. Among variables of corporate governance that are commonly employed is institutional ownership. According to Elyasiani et al. (2017), one type of institutional ownership is monitoring institutions, classified as independent and dedicated institutions. The proportion of institutional investors is inversely proportional to earnings management. Several studies that succeeded in proving the negative effect of institutional ownership on earnings management are conducted by Sofia & Murwaningsari (2019), Sirat (2012), Osta (2011), dan Sumanto et al. (2014).

The agency theory by Jensen & Meckling (1976) stated that one of the efforts to anticipate agency problems is by ownership structure, including institutional ownership. Thus, institutional ownership is owned by institutional investors, including investment companies, government agencies, and foreign investors. The presence of institutional investors is considered to be able to increase the monitoring in order to avoid the potential of earnings management. Nevertheless, Al-Fayoumi et al. (2010), D. Agustia (2013), Siregar (2017), and Nuryana & Surjandari (2019) failed to prove the correlation between institutional ownership

and earnings management. Further and on the contrary, studies by Handayani & Wksuana (2020), Setiawati & Lieany (2016), and Jao & Pagalung (2011) proved that institutional ownership had a positive effect on earnings management.

Institutional investors tend to focus more on the current year earning has become the reason to increase earnings management more than the institutional ownership (Potter, 1992). Therefore, management responds to the situation by applying earnings management to achieve the target for the current year earning established by the investors. Despite the debate among findings of the study, by employing agency theory, this study proposes the following hypothesis:

H3: Institutional ownership negatively affects earnings management.

Based on the agency theory, the audit committee is also considered one of the controlling mechanisms to reduce earnings management. Furthermore, the primary purpose of an independent and qualified audit committee establishment is to avoid any fraudulence by the directors. By employing agency theory, several studies conducted by Alzoubi (2019), Isa & Farouk (2018), Umar & Hassan (2018), Waweru (2018), Agyei-Mensah & Yeboah (2019), Daoud (2018), dan Albersmann & Hohenfels (2017) succeeded to prove the negative effect of the audit committee on earnings management. Nevertheless, upon the involvement of the chief of the board of directors within the committee, there is a potential risk for the emergence of earnings management (Al-Absy et al., 2020). Accordingly, by assuming that the sample of the audit committee is free of any involvement from the chief of the board of directors, the study proposes the following hypothesis:

H4: Audit committee negatively affects earnings management.

2. RESEARCH METHOD

This study applied a quantitative approach in the form of data panel regression. The company sampling was conducted purposively with a total observation data of 54. There are two considerations in data sampling in this study: the availability of company financial statements and the company is preferable for those not experiencing any losses. Thus, the companies taken as sample are as follow: Adaro, Baramulti, Darma Henwa, Indo Tambangraya, RAI, Mitrabara, Samindo, Bukit Asam, dan Toba Bara. This study put earnings management as the dependent variable (Y) with independent variables including profitability (X1), firm size (X2), institutional ownership (X3), and audit committee (X4). The following is a detailed of operational of the variables employed in this study:

Table 1. Operational Definition

Variable	Label	Definition	Measurement
Earnings management	DA	A company's strategy to deliberately manipulate its accruals by exploiting the flexibility of accounting regulation to temporarily improve its financial performance (Dechow & Skinner, 2000)	Jones' model modified by Dechow et al. (1995) : $DA_{it} = \frac{TA_{it}}{A_{it}} - NDA_{it}$
Profitability	ROA	the degree to which a business or activity yields profit or financial gain (Boadi et al., 2013)	$ROA = \frac{\text{Net Income}}{\text{Total Asset}}$
Firm Size	SIZE	The size of a particular company based on its total assets	A natural algorithm of the firm's total asset (Hassan & Ahmed, 2012)
Institutional Ownership	IO	Shares owned by institution such as investment companies, foreign investors, and other institutions	The percentage of the share owned by institutional investors divided by the total circulated shares. (Barako et al., 2006)
Audit Committee	AC	An independent internal auditors established by commissioner boards to proceed internal control and monitor the firm	The number of audit committee

The research model was determined by the Chow test, Breusch Pagan LM test, and Hausman test. Additionally, classical assumption was also a part of the consideration in determining the research model. The classical assumption consists of normality, multicollinearity, autocorrelation, and heteroscedasticity tests. The similarity in data panel regression is as follow :

$$DA = \alpha + \beta_1 ROA_{it} + \beta_2 SIZE_{it} - \beta_3 IO_{it} - \beta_4 AC_{it} + \epsilon_{it} \quad (1)$$

3. RESULTS AND ANALYSIS

This study also applied descriptive statistical analysis to describe the central tendency of the data of the study. The statistical analysis result of this study is as follow:

Table 2. Statistics Descriptive

	ROA	LnSIZE	IO	AC	DA
Mean	0.118	2944	0.658	3.166	-0.147
Median	0.106	2905	0.651	3.000	-0.150
Maximum	0.394	3225	0.932	4.000	0.088
Minimum	0.000	2763	0.260	2.000	-0.300
Std. Dev.	0.094	132.9	0.211	0.423	0.089
Skewness	0.949	0.728	-0.267	1.003	0.576
Kurtosis	3.557	2.445	1.981	4.013	3.022
Probability	0.0122	0.064	0.225	0.003	0.224
Sum	6.396	158986	35.554	171.0	-7.935
Sum Sq. Dev.	0.477	936818.1	2.366	9.500	0.424
Observations	54	54	54	54	54

Note: Unit for ROA, IO, and DAit can be in percentage as mere ratio data. Ln Size is calculated from the total assets in the Indonesian Rupiah, while AC is the sum of the audit committee's actual amount.

Source: Data processed 2021

Table 2 shows that the earnings management average reaches -14% with a relatively equal distribution based on its deviation standard. The negative value indicates a negative earnings management, also known as an earning decrease. A negative symbol indicates a strong relationship between earnings management and tax avoidance. Company management tends to avoid high taxes. Next, the average profitability reaches 11.8%, indicating a better value than the average value of ROA in other industries.

Based on table 2, institutional ownership is predominant by 66%. Thus, an optimum role of investors in institutional ownership can effectively proceed with the monitoring and reduce the risk of information asymmetry. On the other hand, big firm size can increase the agency conflict and information asymmetry upon the lack of audit committee. Nevertheless, the average value of the audit committee in table 2 is 3, with the maximum number of members reaching 4. The following is the classical assumption result and the assigned research model:

Table 3. Classical Assumption Test

	Common	Fixed	Random
Jaque Berra (sig)	1.819 (0.402)	3.553 (0.169)	1.582 (0.453)
Durbin Watson	1.763	2.004	1.571
Chow Likelihood	-	6.084 (0.000)	-
Hausman	-	-	6.751 (1.496)
Breusch Pagan LM	3.007 (0.062)	-	-

Based on the result of Chow and Hausman and Berusch Pagan LM tests, there is an inconsistency in determining the research model. Chow test shows that the fixed effect is better than the common effect. On the other hand, according to the Hausman test, the fixed effect is not better than the random effect. Simultaneously, based on the Berusch Pagan LM test result, the common effect is considered better than the random effect. This study also

considers the classical assumption test result consisting of normality, autocorrelation, and multicollinearity in response to the findings.

The normality test by Jaque Berra shows that all models have normal distribution as the sig or prob value > 0.05. The Durbin Watson test indicates that only the common effect and fixed effect of being free of autocorrelation disturbance. Meanwhile, the data normality quality based on the Jaque Berra value shows that the normality model of the common effect tends to be more qualified than the fixed effect as its value is nearly 1. Accordingly, this study decided to apply the common effect, also known as *pooled ordinary least square*. The following table shows the multicollinearity test of this study:

Table 4. Correlation Matrix

	ROA	IO	LnSIZE	AC
ROA	1.000	-	-	-
IO	0.575	1.000	-	-
LNSIZE	-0.227	-0.311	1.000	-
AC	0.152	0.109	0.403	1.000

Table 4 shows that the correlation between free variables in this study does not exceed 0.9; therefore, the research model does not indicate any multicollinearity disturbance. The following table shows data panel regression results by using *pooled OLS* model, also known as the common effect model:

Table 5. Data Panel Regression Analysis Result

	B	T	Sig.
(Constant)	-0.015	-0.090	0.928
ROA	0.067	0.553	0.582
LnSIZE	-0.001	-2.791	0.007**
IO	0.086	2.018	0.049**
AC	-0.081	-3.730	0.000*
R ²	0.470		
Adj R ²	0.426		
Std Error	0.071		
F-Stat	10.868		
F (Prob)	0.000		

*significant at 0,01 level, **significant at 0,05 level

Table 5 indicates that this research model has a simultaneous effect of 0.47 (R²), which means the variant of variable Y is determined by 47% of the variant change of the free variables of the study, and the remaining 53% is by other external variables. Meanwhile, the result of the data panel regression equation of this study is as follow:

$$DA = -0.015 + 0.067 ROA_{it} - 0.001 LnSIZE_{it} + 0.086 IO_{it} - 0.081 AC_{it} + 0.071_{it} \quad (1)$$

The equation indicates the notion that the institutional ownership and firm size do not meet the prediction. In comparison, the profitability and audit committee produced the

expected symbols. The profitability is marked with a positive symbol; thus, the correlation between ROA and earnings management is positive. Upon hypothesis acceptance, the high profitability proxied by ROA will result in earnings management. The audit committee is marked with a negative symbol; thus, it is expected to reduce the potential risk of earnings management. At the same time, the institutional ownership that was predicted as negative showed an opposite result. The regression equation result shows that institutional ownership is directly proportional to earnings management. Thus, the regression equation indicates the significant effect between free variables on dependent variables. -0.015 is the constant value that refers to the earnings management value when the sum of all free variables is assumed to be zero. Further, this equation result shows the ROA effect of 6.7%, firm size of 1%, and AC of 8.1%, while the error value of this research regression model is 7.1%.

Based on table 5, the first hypothesis is rejected due to the sig value that indicates the ROA effect on earnings management >0.05 . Atas dasar itu, besaran pengaruh ROA yang sebesar 6,7% dari persamaan regresi dinyatakan tidak mendapat dukungan secara statistik. Accordingly, the 6.7% effect of ROA based on the regression result is not supported statistically. In other words, ROA does not affect earnings management. The result is in line with research by Agustia & Suryani (2018), Amelia & Hernawati (2016), and Gunawan et al. (2015). The primary reason for the insignificant effect of ROA on earnings management is the absence of an effective controlling mechanism provided by the firm, especially in minimizing the potential risk of earnings management. Besides, the result also indicates that the earnings management's motive in coal mining industry firms is not to attract potential investors or improve the appearance of financial statements for funding purposes.

By referring to table 5, the firm size negatively affects earnings management. argument The finding is in line with Watts & Zimmerman (1986) that argued that the firm size enabled an effective controlling system that reduced the potential risk of earnings management based on the positive accounting theory. Additionally, there are similar findings by Santi & Wardani (2018), Prasetya & Gayatri (2016), Jao & Pagalung (2011), Taco & Ilat (2016), Arthawan & Wirasedana (2018), Swastika (2013), Sirat (2012), and Ahmad et al. (2014). Therefore, this study indicates that a firm with a bigger size tends to have an adequate controlling mechanism. Besides, the firm size also leads the regulator enrolment in controlling the firm activities to create a conducive business situation.

This study also found a positive effect of institutional ownership on earnings management. In other words, institutional investor ownership has a direct proportion to

earnings management Nevertheless, this finding contradicts the agency theory of Jensen & Meckling (1976) that proposes that institutional ownership can become one of the efforts to anticipate the emergence of agency problems in avoiding earnings management. The result is also supported by the research conducted by Sofia & Murwaningsari (2019), Sirat (2012), Osta (2011), and Sumanto et al. (2014) that proposed the negative effect of institutional ownership on earnings management. Nevertheless, this study is relatively in line with the research result of Handayani & Wksuana (2020), Setiawati & Lieany (2016), and Jao & Pagalung (2011) that found the positive effect of institutional ownership on earnings management.

The third hypothesis' test result proves that the improvement of the controlling process does not accompany the high institutional ownership in coal mining industry firms, despite the descriptive analysis result that shows the average institutional ownership in coal mining industry firms is relatively high. This condition results from the institutional investors that are more interesting in the current year earning (Jao & Pagalung, 2011) and the urge for the management to achieve investors target earning, which encourages the management to perform earnings management. Therefore, the managerial ownership and the increase of shareholders' monitoring process are necessary to balance the situation.

Further, this study proves that the audit committee negatively affects earnings management, which means that the fourth hypothesis is accepted; the audit committee quantity is directly proportioned to the reduction potential of earnings management The finding is in line with previous study by Alzoubi (2019), Isa & Farouk (2018), Umar & Hassan (2018), Waweru (2018), Agyei-Mensah & Yeboah (2019), Daoud (2018), and Albersmann & Hohenfels (2017). This study also indicates that the audit committee quantity can serve the function of reducing earnings management. Further, the study results indicate that currently, the audit committee in firms tends to be proportional and independent; thus, it can work efficiently to avoid the emergence of earnings management. The more significant the audit committee is, the more professional the work process and decision-making are within the committee.

4. CONCLUSION

Based on the analysis result, this study becomes empirical evidence that firm profitability does not affect earnings management. This condition indicates that the high profitability does not increase nor reduce the managerial tendency to perform earnings management. Besides, this study found a negative effect of firm size on earnings management.

Big firms relatively cause the increase in the controlling process, both from shareholders and regulator sides, which eventually reduce the potential risk of earnings management.

Another result of this study is that institutional ownership has a positive effect on earnings management. This finding indicates that the orientation of coal mining institutional investors still on the current year earning. Therefore, the institutional investors are expected to maximize their function in monitoring the managerial performance to avoid the earnings management practices. This study reveals that audit committee has a negative effect on earnings management, which means the more independent and significant quantity the committee is, the more effective the monitoring is to minimize the earnings management potential.

The stakeholder, in this terms, is the Financial Authority Service of Indonesia (OJK), which is expected to increase the monitoring service to minimize the potential risk of earnings management practices to respond to the institutional ownership's inability to maximize the reduction of the practice. Therefore, future studies are expected to add the number of sample and data observations and employ more than one research method to produce more robust results related to the determinant factors of earnings management. Additionally, future studies are suggested to include other variables, such as audit quality, the number of commissioners members, leverage, managerial ownership, and the involvement of the chief of commissioner boards in the audit committee as the free variable assumed to have effects on earnings management.

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