

# *CORPORATE GOVERNANCE AND SOCIALLY RESPONSIBLE ON ACCOUNTING CONSERVATISM AND EARNINGS MANAGEMENT IN INDONESIA'S SOE ENTERPRISES*

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## **ABSTRACT**

*This study aims to analyze the implementation of governance practices and social activities in minimizing earnings management practices by strengthening conservative reporting practices in Indonesian State-Owned Enterprises (SOE). This study uses an explanatory model with a quantitative approach to achieve the research objectives. The data used are 10 companies with an observation period from 2014-2019 so that there are 60 observations. Partial Least Square modeling with the help of WarpPLS software was used to test and explain the effect of each construct and latent variable. Our findings reveal that the corporate governance has no significant effect on conservative financial reporting practices so that this triggers the ineffectiveness of companies in avoiding earnings management practices. Meanwhile, it was found that CSR practices had a significant effect in minimizing managers in SOE enterprises to act opportunistically, but did not significantly affect implementing conservative reporting practices. This research is expected to be able to provide recommendations in minimizing the manipulation of financial statements through strengthening CG, CSR, and AC practices in state-owned enterprises. In addition, this research can provide new insights in the empirical review that is inconsistent in previous research.*

**Keywords:** *Corporate Governance (CG), Corporate Social Responsibility (CSR), Accounting Conservatism (AC), Earnings Management (EM), Indonesia's SOE Enterprises*

## **ABSTRAK**

Penelitian ini bertujuan untuk menganalisis penerapan praktik tata kelola dan aktivitas sosial dalam meminimalkan praktik *earnings management* dengan memperkuat praktik pelaporan konservatif di Badan Usaha Milik Negara (BUMN) Indonesia. Penelitian ini menggunakan jenis penelitian *explanatory* dengan pendekatan kuantitatif untuk mencapai tujuan penelitian. Data yang digunakan adalah 10 perusahaan dengan periode pengamatan dari tahun 2014-2019 sehingga terdapat 60 pengamatan. Analisis data menggunakan *Partial Least Square* dengan bantuan *software* WarpPLS digunakan untuk menguji dan menjelaskan pengaruh masing-masing konstruk dan variabel laten. Hasil penelitian mengungkapkan bahwa *corporate governance* tidak berpengaruh signifikan terhadap praktik pelaporan keuangan konservatif sehingga memicu ketidakefektifan perusahaan dalam menghindari praktik *earnings management*. Sementara itu, ditemukan bahwa praktik CSR berpengaruh signifikan dalam meminimalkan manajer di perusahaan BUMN untuk bertindak oportunistik, tetapi tidak berpengaruh signifikan terhadap penerapan praktik *accounting conservatism*. Penelitian ini diharapkan mampu memberikan rekomendasi dalam meminimalisir manipulasi laporan keuangan melalui penguatan praktik CG, CSR, dan AC di perusahaan BUMN. Selain itu, penelitian ini dapat memberikan wawasan baru dalam tinjauan empiris yang tidak konsisten dengan penelitian sebelumnya.

**Kata Kunci:** *Corporate Governance (CG), Corporate Social Responsibility (CSR), Accounting Conservatism (AC), Earnings Management (EM), Perusahaan BUMN Indonesia*

## 1. INTRODUCTION

Modern accounting history records that earnings management activities increased more rapidly in the period 1997-2002 which was marked by the disclosure of accounting scandals involving large US companies such as Enron, Merk, Xerox, and Worldcom (Alim, 2013). While in Indonesia itself, fraudulent practices in financial statements are ranked third. Based on a survey conducted by ACFE in 2016 there were 10 cases of manipulation in financial statements and an increase in 2019 which found 22 cases (ACFE Indonesia Chapter, 2019; Murdock, 2018). Among the many cases found, several state-owned companies were found to be involved in this case, such as PT Garuda Indonesia, PT Jiwasraya, and PT Asabri.

Companies both small and large scale, certainly have the potential to take earnings management actions, be it lowering, increasing or smoothing accounting profits. This is because each company has the main goal of making a profit and in general each company has a certain strategy to obtain the desired profit. However, not all strategies can be accepted by norms or ethics such as the practice of profit manipulation. The practice of manipulating earnings in financial statements or earnings management is one of the unethical actions because top managers use flexibility in accounting to manage accounts so that they will achieve the expected profit goals (Kassem, 2013).

Corporate governance is considered capable of improving the quality of financial reports by maximizing the role of the board in limiting management's opportunistic actions and ensuring that informed earnings are accurate and accountable (Chen & Zhang, 2014; El Diri et al., 2020; Xie et al., 2003). Governance structures such as the board of directors may have a role in minimizing earnings management. The Blue-Ribbon Panel recommends that board members serving on audit committees should be financially proficient to help detect earnings management (Xie et al., 2003). Because independence is needed to carry out supervision, ideally the ranks of the board of directors are filled by independent parties. Investors believe that companies that have board independence representation will be more effective in evaluating management and monitoring (Wang, 2015). This is in line with

the regulations listed in Indonesia where public companies listed on the IDX are required to have an independent audit committee and board of commissioners (Otoritas Jasa Keuangan, 2014).

Recent studies have also discussed a lot about the relationship between CSR and earnings management (Buerthey et al., 2020; Gras-Gil et al., 2016; Grougiou et al., 2014; Leventis et al., 2013). Through CSR initiatives, companies can maximize shareholder value and increase their market share (Buerthey et al., 2020) and when the company has involvement in CSR activities the company has received social support and through CSR activities directly or indirectly management is able to gain legitimacy in the company (Grougiou et al., 2014) and able to increase support from stakeholders if the company wants to continue to exist (Buerthey et al., 2020). The company's involvement in CSR activities not only increases stakeholder satisfaction but also has a positive effect on the company's reputation and reduces the financial risks that may be posed by the company (Gras-Gil et al., 2016). However, several different studies state the opposite that increasing CSR activities will actually increase earnings management practices (Buerthey et al., 2020) and in another study revealed that CSR has no effect on earnings management practices (Grougiou et al., 2014).

The implementation of good governance and CSR mechanisms without being balanced by the selection of the right accounting system is feared not to be able to minimize earnings management practices as well. Accounting conservatism is considered a valuable tool for monitoring management (Caskey & Laux, 2017) because when the company implements a conservative reporting system, the company will be more careful in reporting its finances by not rushing to recognize profits and as soon as possible recognize losses and debts that may occur in the future (Francis et al., 2013). Companies that are able to manage their stakeholders well are able to manage the company in a better direction and will demand the use of conservative reporting practices in order to improve the quality and accountability of earnings (Cheng & Kung, 2016).

This study aims to further analyze the implementation of governance and CSR mechanisms in Indonesian state-owned companies in implementing accounting conservatism practices to minimize opportunistic management actions. Although there are many studies that explain the relationship between governance, CSR, accounting conservatism and earnings

management, this concept is still very rarely used in companies, especially SOEs in Indonesia. SOE enterprises are considered to have their own uniqueness. The government which has full control over the running of the company is considered to have great power in terms of supervision and improvement of financial quality. One of the advantages of SOE enterprises by achieving these two main focuses is that SOE enterprises are able to benefit from company operations and get a positive image from investors because of their social actions so they can increase public trust and will later affect company profits. The results of this study can contribute to strengthening the practice of governance and CSR on the quality of financial reporting in State-Owned Enterprises (SOE) in Indonesia. Furthermore, the results of this study will also provide some empirical explanations regarding the inconsistencies in the literature regarding the relationship between corporate governance, CSR, accounting conservatism and earnings management.

## **2. LITERATURE REVIEW**

### ***Agency Theory***

Agency theory is formed from the separation between ownership and control in the company. The existence of these differences is a conflict of interest between the agent (manager) and the principal (shareholder). The conflict occurred because of various allegations, such as; 1) agents do not always act in the best interests of the principals, or maximize personal gain so as to be detrimental to the principal; 2) because agents do not always act in the interests of the principal, the principal tends to incur more costs to exercise control over the agents and provide promotions or rewards for their performance in the hope that the agents will achieve the goals desired by the principal (El Diri et al., 2020).

### ***Stakeholder Theory***

Based on the perspective of stakeholder theory, the main responsibility of the business as a whole is responsibility to the community, government, and suppliers, or based on this theory the essence of business mainly lies in building relationships and creating value for all stakeholders. The involvement of companies in implementing CSR is one of the

socially supported ways in which companies meet the expectations of other stakeholder groups. Through CSR activities, company managers are able to provide legitimacy and get support from stakeholders and this support is very important for the manager in maintaining his position (Leventis et al., 2013).

### ***Social Norm Theory***

Social norms play an important role in financial and auditing decisions. Social norms are able to reduce irregularities in financial reporting and tax avoidance, besides that capital market participants also recognize the role of social norms in reducing aggressive financial reporting. Social norms will motivate institutions to engage in positive activities.

### ***Corporate Governance***

Corporate governance is a set of mechanisms to ensure that the company's assets are used as efficiently as possible and guarantee profits for its investors and thus prevent the improper distribution of assets to managers or other irresponsible parties at the expense of other interests, so that good governance will result in better management monitoring (García Lara et al., 2009). The implementation of good corporate governance is able to minimize agency costs, can prevent acts of abuse of authority by the directors in managing the company, and improve the quality of the company's financial reports. In addition, the International Finance Corporation (IFC) also stated that companies that implement good corporate governance will be able to boost performance and improve operational efficiency, as well as increase asset value and build company reputation (Dwiridotjahjono, 2009; Otoritas Jasa Keuangan, 2014).

### ***Corporate Social Responsibility***

Socially responsible carried out by the company is one form of social norms that has been shown by the company. Over the last decade, social responsibility activities emerged as a valid code of corporate behavior that was endorsed and considered an important aspect and reflects modern business ethics in the context of capital markets (Leventis et al., 2013). Social responsibility activities are associated with moral and ethical aspects. In previous studies, it was stated that companies carrying out social activities not only increase stakeholder satisfaction but are also able to increase the company's image or

reputation and are able to pressure managers to avoid opportunistic actions (Gras-Gil et al., 2016).

### ***Accounting Conservatism***

Accounting conservatism can also be referred to as a precautionary concept because the company will recognize losses earlier than profits. Managers who prepare financial statements are required to use more conservative measures. The accounting conservatism literature focuses on asymmetric accounting responses to good news and bad news. The existence of agency problems is caused by differences in interests between shareholders and managers (Lin et al., 2014). Conservatism here will reduce the incentives and desire of managers to manage accounting numbers and thereby reduce information asymmetry.

### ***Earnings Management***

Earnings management occurs when company managers intervene in the preparation of financial reporting. This intervention can have a negative impact such as reducing the meaning or information that can be reflected in the financial statements and will be detrimental to the shareholders in particular (Xie et al., 2003). Information becomes a very important part for various parties, especially shareholders, to know the company's performance. Shareholders in the company are not all internal, so information is very important. When managers and shareholders have the same information, there will be no problems related to information asymmetry, on the other hand, when managers have more information and are not conveyed directly to shareholders, it will lead to agency problems.

### ***Corporate Governance and Earnings Management***

The relationship between corporate governance and earnings management can be explained by agency theory. Agency conflict can occur due to the separation of ownership and control of the company. Based on the point of view of agency theory, company managers are considered as parties who have a tendency to be opportunistic through earnings management practices (El Diri et al., 2020). The design of an effective governance mechanism will result in effective monitoring,

fair market competition, can maximize the role of the board effectively and be able to provide fair compensation (Bonazzi & Islam, 2007). Several previous studies have stated that the board of directors plays an important role in monitoring management and protecting the rights of shareholders (Diri et al). In general, the board of directors has members who are independent the more stronger supervisory role for the manager (Chen & Zhang, 2014; El Diri et al., 2020; Fama & Jensen, 2019) and earnings management can be reduced by increasing board independence in the company.

There are two board characteristics that have also received attention in the literature in terms of their impact on earnings management, female board and independent audit committee. Women have a tendency not to be involved in unethical actions and more averse to risk so that the role of women is felt to minimize earnings management practices (Wang, 2015). The audit committee is also seen as a monitoring mechanism that aims to reduce information asymmetry between agents and principals and the more independent audit committee members have a negative and significant effect on earnings management practices in the US (Xie et al., 2003). Based on the explanation, the proposed hypothesis is:

**H<sub>1</sub>: Corporate Governance has a significant effect on earnings management in Indonesian SOE Enterprises**

### ***CSR and Earnings Management***

Corporate Social Responsibility (CSR) is a corporate responsibility that is closely related to ethical and moral aspects. The relationship between CSR and earnings management can be explained by the theory of social norms. Based on this theory, companies that are able to meet the expectations of social norms such as CSR can improve the company's financial quality (Leventis et al., 2013). Previous studies have stated that CSR activities are able to minimize earnings management practices (Gras-Gil et al., 2016) and companies that remain involved in earnings management practices are considered that have not been able to internalize the values contained in CSR practices (Grougiou et al., 2014). However, in a different study (Grougiou et al., 2014) states that CSR activities do not have a significant effect on earnings management, and in this research (Buertey et al., 2020) states that companies involved in CSR activities also have involvement

in earnings management practices, especially in income increasing.

The implementation of CSR activities in Indonesia itself is carried out on the basis of regulatory recommendations from the government such as Law no. 40 of 2007 concerning Limited Liability Companies in which companies in all sectors are required to carry out CSR activities. Then to maximize CSR activities, the Indonesian government sets 2% of the company's profits to be set aside for CSR activities and if the company experiences a loss, the company can carry out a program called Tali Asih and Comdev/CD whose funds are sourced from the company's operations (Linggau Pos, 2018). Cheng & Kung (2016) in their research stated that state-owned companies have a tendency to report their CSR better than other companies because companies have high cooperation with economic policies determined by the government. Based on the explanation, the proposed hypothesis is:

**H<sub>2</sub>: CSR has a significant effect on earnings management in Indonesian SOE Enterprises**

#### *Corporate Governance and Accounting Conservatism*

Corporate governance and accounting conservatism have a relationship with each other. The corporate governance mechanism is a tool to maintain the implementation of accounting conservation and reduce agency conflicts (Alim, 2013). In several other discussions there are those who argue that the practice of accounting conservatism can be a substitute mechanism if the governance mechanism is weak. When governance mechanisms are weak, managers will tend to be conservative in financial reporting to compensate for weaknesses in the governance system (Nasr & Ntim, 2018). Governance structures such as board size, audit committee, ownership structure, and board independence are some of the factors that underlie the company in applying the principle of conservatism (Savitri, 2016). Governance structures such as board size in several studies have a significant effect on the implementation of accounting conservation practices in companies while board independence functions as a supervisor and will improve and support the implementation of higher accounting conservatism (Almutairi

& Quttainah, 2019; Nasr & Ntim, 2018). In a different study, board independence actually reduces the practice of accounting conservatism (Xia & Zhu, 2009). Another structure is the female board and independent audit committee. The results showed that the female board (Almutairi & Quttainah, 2019) and independent audit committee (Leventis et al., 2013) has a positive and significant influence on the company's accounting conservatism. Based on the explanation, the proposed hypothesis is:

**H<sub>3</sub>: Corporate Governance has a significant effect on accounting conservatism in Indonesian SOE Enterprises**

#### *CSR and Accounting Conservatism*

The development of CSR activities was founded on economic responsibility before being expanded to ethical responsibility and public responsibility. Based on stakeholder theory, the company will invest resources to meet stakeholder expectations. Companies may try to use CSR as a tool to change the way stakeholders view the company so that it can improve the company's image (Cheng & Kung, 2016). Several previous study (Cheng & Kung, 2016; Francis et al., 2013) stated that CSR activities have a positive influence on companies to implement accounting conservatism practices. These results indicate that companies that implement CSR will also apply accounting conservatism. However, the results of this study are different which states that companies that get a high CSR predicate are less conservative in reporting their finances. These results indicate that issuers, especially in Korea, use CSR activities only as a strategic means to maintain or complement low-level conservatism (Hong, 2020). SOE companies have high cooperation with economic policies determined by the government so that SOE will have a tendency to report their CSR better and a greater tendency to demand the use of accounting conservatism (Alkurdi et al., 2017; Cheng & Kung, 2016). Based on the explanation, the proposed hypothesis is:

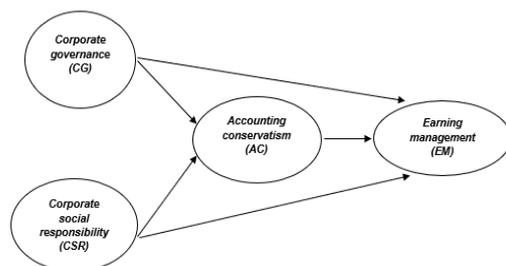
**H<sub>4</sub>: CSR has a significant effect on accounting conservatism in Indonesian SOE Enterprises**

#### *Accounting Conservatism and Earnings Management*

The influence between accounting conservatism and earnings management) can be explained through agency theory, especially on information asymmetry. Managers feel they have more

information about the company's performance compared to shareholders, and not all managers act on behalf of shareholders. The accounting conservatism literature focuses on asymmetric accounting responses to good news and bad news. The agency problem is caused by differences in interests between shareholders and managers. Conservatism here will reduce the incentives and desire of managers to manage accounting numbers and thereby reduce information asymmetry (Lin et al., 2014). Companies classified as implementing a higher conservatism level will be less involved in earnings management. Meanwhile, companies classified as lesser conservatism level will be more involved in earning management (Haque et al., 2016). Different results are shown in research Lin et al (2014) which states that companies with low institutional ownership ratios and high conservatism will increase earning management activities. Companies that have high institutional ownership ratios and low conservatism practices will reduce earning management activities, and if companies practice conservatism and high institutional ownership ratios will increase earning management activities. Based on the explanation, the proposed hypothesis is:

**H<sub>5</sub>: Accounting conservatism has a significant effect on earnings management in Indonesian SOE Enterprises**



**Image 1 Hypothesis Model**

Source: Research Results, 2021

### 3. RESEARCH METHODS

This research uses explanatory research with a quantitative approach. This type of research and approach is considered capable of answering the problem and explain the influence of corporate governance and

corporate social responsibility on accounting conservatism and their impact on earnings management in state-owned enterprises for the period 2014-2019. The sampling technique is purposive sampling by limiting the selection of samples based on certain criteria<sup>1</sup>. This research was conducted on the Indonesia Stock Exchange (IDX). The sample used in this study amounted to 10 state-owned companies that have gone public with an observation period of six years so that the total observation is 60 firm-years. Following previous research (El Diri et al., 2020; Gras-Gil et al., 2016) we do not use financial and banking companies in the sample because financial companies have unique accounting and finance practices and follow different regulations. In addition, we do not use financial companies because these companies have different CSR programs.

**Measuring Corporate Governance:** In this study, we use governance structures such as board size (BSize), board independence (BI), female board (Fboard) and independent audit committee (IndAudCm). For the board size we use the total number of the company's board of commissioners (Nasr & Ntim, 2018). For the female board, we calculate by dividing the number of female commissioners by the total number of commissioners (Wang, 2015). And the last is the independent audit committee where we calculate by dividing the number of independent audit committees divided by the total number of audit committee members (Leventis et al., 2013).

**Measuring CSR:** In this study, we measure social performance through the disclosure of CSR activities (CSDI) with GRI G4 standards. In this standard the social activities assessed consist of various aspects such as economic, environmental, and social aspects (product responsibility, society, human rights, labor practices and work comfort). We will give a score on each social activity disclosed by the company, a "1" will be assigned to the item in each disclosed aspect and a "0" score will be given for the undisclosed item. There are 91 items used to assess CSR based on GRI standards and can be viewed at [www.gri.go.id](http://www.gri.go.id).

**Measuring Accounting Conservatism:** In this study, accounting conservatism is measured by accrual-based measurements based on the Basu

<sup>1</sup> 1) SOE that are listed on the IDX and use the same regulations in preparing their financial statements; 2) Publish annual reports in a row from

2014 to 2019; 3) Published sustainability reports based on GRI G4 standards successively from 2014 to 2019.

Model (1997) and the Givoly & Hayn Model (2002). Basu's (1997) model states that conservatism is more in tune with negative returns than positive returns. The regression model is as follows:

$$\frac{EPS_{it}}{P_{it}} = \beta_0 + \beta_1 DR_{it} + \beta_2 R_{it} + \beta_3 D_{it} R_{it} + \varepsilon \quad (1)^2$$

The relationship between earnings sensitivity to good news and bad news is shown by the Basu coefficient:

$$Coefficient_{Basu} = (\beta_{2i} + \beta_{3i}) / \beta_{2i} \quad (2)$$

Companies are considered to use conservative reporting if the earnings response to negative returns must be more than 0 (Cheng & Kung, 2016). The second measurement is based on the model of Givoly & Hayn (2002). As for measuring using this model are as follows:

$$CONS_{it} = \frac{(IBEXT_{it} + DEP_{it} - CFO_{it})}{Average\ Total\ Assets} (-1) \quad (3)^3$$

**Measuring Earnings Management:** In this study, we use the measurement indicator of discretionary accruals to measure the involvement of state-owned companies in earnings management practices. There are two models that we use to measure discretionary accruals, namely the Modified Jones Model (1991) and the Kothari et al (2005) Model. In general, these two models have the same steps for calculating discretionary accruals, which are formulated as follows:

$$DA_{i,t} = \left( \frac{TAC_{i,t}}{TA_{i,t}} \right) - NDA_{i,t} \quad (4)$$

Where TAC is the company's Total Accruals divided by TA, namely total assets and the results are reduced by non-discretionary accruals (Chen & Zhang, 2014). The difference between these two models is the inclusion of Return on Assets (ROA) to calculate the value of non-discretionary accruals and total accruals. The ROA element is used as an item that is considered capable enough to minimize specification errors so as

to be able to measure earnings management more accurately (Suyono, 2017).

#### 4. RESULT AND DISCUSSION

##### Descriptive Statistical Analysis

Statistical analysis was used to describe the effect of corporate governance (CorpGov) and Corporate Social Responsibility (CSR) variables on Accounting Conservatism (AccCons) and their impact on Earnings Management (EarnMan). The results of the descriptive statistics can be seen in table 1 below:

**Table 1. Descriptive Statistical Analysis**

Indicators	Min	Max	Mean
BSize	5	7	6,05
BI	0,2857	0,5000	0,3510
FBoard	0,0000	0,3333	0,0345
IndAudCom	0,1667	1,0000	0,8417
CSDI	0,1319	0,9560	0,3793
MBasu	0,0054	1,0000	0,4530
MGivHayn	-0,2131	0,0917	-0,2160
MModJones	-0,0149	0,0425	0,0045
MKothari	-0,0149	0,0428	0,0045

Source: SPSS 26.00 Output, 2022

##### Outer Model

The evaluation of the outer model serves to show the relationship between the indicator and its latent variable. This study uses the significance of weight with a formative model. The results of the outer model can be seen in table 2 below:

**Table 2. Evaluation of Outer Model**

Indicator	Weight	Se	P-Value	Description
BSize	0,501	0,108	<0,001	Valid
BI	-0,490	0,109	<0,001	Valid
FBoard	0,341	0,115	0,002	Valid
IndAudCom	0,300	0,116	0,006	Valid
CSDI	1,000	0,091	<0,001	Valid
MBasu	0,683	0,102	<0,001	Valid
MGivHayn	0,683	0,102	<0,001	Valid
MModJones	1,000	0,000	1,000	Not Valid*
MKothari	1,000	0,091	<0,001	Valid

Source: WarpPLS 6.0 Output, 2022

<sup>2</sup>  $EPS_{it}$  is the company's earnings per share,  $P_{it}$  is the stock price at the beginning of the year, DR is a dummy variable, 1 if R is negative and 0 otherwise, R is stock returns,  $\varepsilon$  is standard error.  $\beta_2$  represents the level of profit response to positive returns, while  $\beta_3$  represents the level of profit response to negative returns.

<sup>3</sup>  $CONS$  is Earning conservatism based on accrued items,  $IBEXT$  is Net income before extraordinary items,  $DEP$  is Depreciation of fixed assets of current year, and  $CFO$  is Net amount of cash flow from operating activities. If the result of  $CONS$  is positive, this means that more accounting conservatism is reported, and if it is negative, the company tends to be less conservative in its reporting.

**Inner Model**

The evaluation of the inner model is used to determine the ability of endogenous variables to explain the diversity of exogenous variables. In this study using the Goodness of Fit Model. The results of the analysis can be seen in table 3 below:

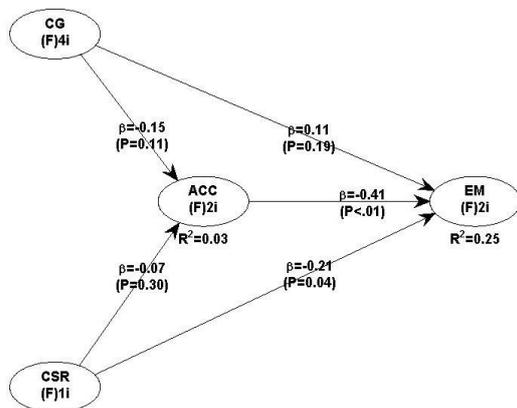
**Table 3. Goodness of Fit Model**

Latent Variable	R-Squares	Q Squares
Accounting conservatism	0,027	0,060
Earnings management	0,249	0,266

Source: WarpPLS 6.0 Output, 2022

**Hypothesis Testing**

Hypothesis test serves to see the effect of each variable. Meanwhile, if the p-values level of significance (alpha = 5%) then it is stated that there is a significant effect.



**Image 2 Hypothesis Testing Result**

Source: WarpPLS 6.0 Output, 2022

**Table 4. Hypothesis Test Results**

Exo	Endo	Path Coef	Se	P-Value
CG	EM	0,110	0,124	0,191
CSR	EM	-0,212	0,120	0,041
CG	AC	-0,151	0,122	0,111
CSR	AC	-0,068	0,126	0,295
AC	EM	-0,408	0,112	<0,001

Source: WarpPLS 6.0 Output, 2022

**Discussion**

**Corporate Governance and Earnings Management**

The results of the analysis are shown in table 4 which shows that corporate governance does not have a significant effect (0.191 > 0.05) on earnings management in Indonesian state-owned companies. These

results indicate that the corporate governance mechanism cannot be used as a benchmark for management to engage in earnings management practices, where the results of this study reject the proposed hypothesis (H<sub>1</sub>). The results of the descriptive analysis in table 1 show that the governance structure, especially the board independence structure (35.10%) and the independent audit committee (84.17%) has been well represented regarding the rules that require companies to have these two structures to oversee the company's management. While for earnings management practices, descriptive results show that both earnings management measurements show a positive value (0.0045), which means that companies tend to practice earnings management using the profit-increasing method (Handoko & Ahmar, 2016). Empirically, these results do not support that state-owned companies have an advantage in directing management to make effective decisions (Alkurdi et al., 2017) so that it will improve the quality of earnings (Xia & Zhu, 2009), and theoretically these results do not support agency theory which shows that governance mechanisms are able to prevent agency problems such as earnings management. This result is probably because Indonesian state-owned companies have indications of malpractice of abuse of authority and power by the government through its representatives in the company (Worang & Holloway, 2006) and the governance mechanism in Indonesian state-owned companies is considered not optimally, especially the role of the board independence and independent audit committee because the two governance structures are considered unable to run optimally in countries with low governance mechanisms such as in Indonesia (Francis et al., 2013; Puspitaningrum & Atmini, 2012). The performance of governance in state-owned companies that is not optimal means that management feels that it is not being monitored optimally by the company's board so that managers feel they have the opportunity to practice earnings management. On the other hand, there is a tendency to compensate top managers based on company performance (Rahayu et al., 2019) will strengthen the desire of managers to practice earnings management with the method of increasing profits because the greater the profit earned, the greater the compensation received by the manager.

**CSR and Earnings Management**

The results of the analysis shown in table 4 show that CSR has a significant effect (0.041 <

0.05) on earnings management in Indonesian state-owned companies. These results indicate that CSR practices can be used as a benchmark for companies to engage in earnings management practices in SOE enterprises, where the results of this study support the proposed hypothesis (H<sub>2</sub>). The results in the descriptive analysis show that on average, state-owned companies disclose CSR activities of 37.93%. We think this value is still quite small because the highest disclosure is 95% and the least disclosure is around 13%, while earnings management in both types of measurement shows a positive value (0.0045) or companies tend to practice earnings management with the profit-increasing methods (Handoko & Ahmar, 2016). In the hypothesis test results, CSR path coefficient shows a value of -0.212, which means that low disclosure of CSR activities will increase the tendency of managers to engage in earnings management practices, especially the practice of increasing profits. Theoretically, the results of this study do not support the social norms theory which shows that companies highly value social norms such as CSR practices will have a tendency to avoid actions that can damage the company's image (Grougiou et al., 2014).

The practice of implementing CSR in Indonesian SOE enterprises is reported to be still not optimal. There are several findings that state-owned companies are reported to be involved in cases such as misappropriation of CSR funds such as in PT. Pertamina and PT. Garuda Indonesia (Cnbc Indonesia, 2019). This finding empirically does not support some of the statements of previous research (Cheng & Kung, 2016; Kartasasmita, 2020) which states that state-owned companies have a tendency to report CSR activities better because the company has high cooperation with the government as the regulator as well as the company's controlling shareholder. But on the other hand, state ownership can also weaken the positive relationship between CSR and the level of company earnings quality. Management will focus on fulfilling government policies in following guidelines related to CSR and also managers in state-owned companies generally carry out CSR activities as a means to gain legitimacy and improve communication with the government to maintain resource allocation (Cheng & Kung, 2016).

### *Corporate Governance and Accounting Conservatism*

The results of the analysis shown in table 4 show that corporate governance has an insignificant effect ( $0.111 > 0.05$ ) on accounting conservatism in Indonesian state-owned companies. These results indicate that the governance mechanism cannot be used as a benchmark in companies to implement accounting conservatism practices, so this result rejects the proposed hypothesis (H<sub>3</sub>). Based on the results of descriptive statistical analysis of the composition of the board size, the representation of the independent board, the representation of women and the independent auditors have followed the applicable rules which are based on the regulations of the Financial Services Authority (OJK) where the minimum number of the board of commissioners is two people, one of which is the chairman of the commissioner and others become independent commissioners and at least the audit committee has independent members (Otoritas Jasa Keuangan, 2014). Meanwhile, for the practice of accounting conservatism, the results of the descriptive analysis show that when measured using the Basu Model, the average value is 0.4530. Cheng & Kung (2016) states that companies are judged to use conservative reporting if the earnings response to negative returns must be more than "0" while the average value in this study is not more than 0 so it can be concluded that by using the Basu model measurement, SOE enterprises in Indonesia have not implemented comprehensive conservative report. Meanwhile, based on the Givoly & Hayn measurement model, the average value is -0,2160. Accruals with a negative sign indicate that the company tends to be less conservative (Nasr & Ntim, 2018). So, it can be concluded that by using the Givoly & Hayn model measurement, state-owned companies in Indonesia have a tendency to report less conservative financial statements.

Empirically the results of this study support research from Xia & Zhu (2009) which states that corporate governance mechanisms often cannot function optimally. In China, for example, board independence is considered unable to optimally voice its aspirations towards minority shareholders and board independence tends to agree with majority shareholders regarding financial reporting. so that the greater the board independence composition will give the majority shareholders more power. Although the results of this study contradict several previous studies which state that corporate governance

mechanisms are able to strengthen the application of accounting conservatism (Almutairi & Quttainah, 2019; Leventis et al., 2013; Nasr & Ntim, 2018). Theoretically, this study does not support agency theory which states that governance mechanisms that are implemented efficiently and effectively will tend to avoid agency conflicts, especially information asymmetry by supporting the application of accounting conservatism (Leventis et al., 2013). As explained before corporate governance in Indonesia tends to be weak (Utama et al., 2017) and in particular the governance structure in Indonesian state-owned companies is considered not functioning optimally, especially the role of the board independence and independent audit committee due to indications of malpractice of abuse of authority (Worang & Holloway, 2006) and governance cannot function optimally in a country with low governance mechanisms such as in Indonesia (Francis et al., 2013; Puspitaningrum & Atmini, 2012). However, when viewed from the level of application of accounting conservatism, the results show that the state-owned companies in this study apply at a low level and even tend to be less conservative. The low practice of conservatism indicates that the state-owned companies in this study have the potential to implement more conservative financial reporting by maximizing the performance of the independent audit committee and board independence effectively and efficiently considering that management in state-owned companies is directly supervised by the government as the regulator and controlling shareholder and the role from the government itself will direct the management of state-owned companies to improve the quality of earnings (Alkurdi et al., 2017).

#### ***CSR and Accounting Conservatism***

The results of the analysis in table 4 show that CSR has an insignificant effect ( $0.295 > 0.05$ ) on accounting conservatism in Indonesian state-owned companies. These results indicate that CSR activities cannot be used as a benchmark in companies to implement accounting conservatism practices, so this result rejects the proposed hypothesis ( $H_4$ ). Based on the results of descriptive statistical analysis, it is stated that Indonesian state-owned companies on average disclose CSR activities in a fairly low number and the

application of accounting conservatism in both measures is also considered low. Theoretically and empirically, the results of this study do not support previous theories and research. Based on stakeholder theory, companies that are actively involved in CSR practices will tend to be disciplined in providing high-quality earnings information so that it will support conservative reporting practice (Cheng & Kung, 2016). In several studies which state that CSR activities are able to have a positive and significant effect on the implementation of accounting conservatism (Cheng & Kung, 2016; Francis et al., 2013).

CSR practices in Indonesian public companies have been regulated in Law No. 40 of 2007 so that with this regulation every public company in various sectors is required to implement CSR practices, especially in Indonesian SOEs which aim not only to seek profit but are also obliged to fulfill social responsibilities by contributing to the welfare of the community's economy. In addition, SOE enterprises are also directed to be superior and pioneers in the implementation of CSR (Cheng & Kung, 2016) so that it is possible to explain this research is that it is possible for SOE enterprises to use CSR to fulfill their responsibilities as companies that have high cooperation with the government and CSR. used as an identity to build a superior image, especially in social activities, without this tactic having an impact on company policy to use accounting conservatism practices.

#### ***Accounting Conservatism and Earnings Management***

The results of the analysis in table 4 show that accounting conservatism has a significant effect ( $<0.001 < 0.05$ ) on earnings management in state-owned companies. These results indicate that accounting conservatism has a relationship with earnings management practices in Indonesian SOE enterprises, so these results support the proposed hypothesis ( $H_5$ ). Based on the results of descriptive statistical analysis of accounting conservatism in both measurements, it shows that implementation is still low and management in state-owned companies tends to engage in earnings management practices with the profit-increasing method. Empirically these results support previous research which states that accounting conservatism has a significant effect on the involvement of earnings management (Haque et al., 2016; Lin et al., 2014). But theoretically, the results of this study do not support agency theory, especially information

asymmetry which states that information asymmetry that occurs between shareholders and company managers will occur if the manager knows more information and uses it for the benefit of the shareholders so that application requests are needed to reduce encouragement or desire of company managers to be opportunistic (Lin et al., 2014). Based on the results of the hypothesis test, the path coefficient value is -0.390 or is negative. This negative value indicates that the low practice of accounting conservatism will tend to increase the practice of earnings management, especially with the method of increasing profits. The company in preparing its financial statements of course prioritizes the truth so that the results can be accounted for. However, with SOE enterprises in Indonesia where companies with government ownership must of course compile financial reports that must be informative and accountable. However, in the research conducted by Lin et al (2014), it is stated that there is a possibility that companies whose shares are owned by institutional may have prepared financial statements in accordance with the principle of conservatism, but the presence of a high concentration of ownership by one party can increase profit manipulation in the company because of individual interests.

#### Additional Analysis

In additional analysis, we examine the significance of the intervening variable in mediating between exogenous variables and endogenous variables where this intervening variable is accounting conservatism.

**Table 5. Indirect Effect Hypothesis Test Results**

Exo	Mediation	Endo	Ind	Se	P-Value
CG	AC	EM	0,062	0,089	0,247
CSR			0,028	0,090	0,380

Source: WarpPLS 6.0 Output, 2022

Based on table 5 shows that in both effects, accounting conservatism is not able to perfectly mediate between corporate governance and CSR on earnings management. this is indicated by the P-Value value which is greater than the level of significance. The results of the descriptive

statistical analysis on both accounting conservatism measurement indicators show that management in state-owned companies tends to be less conservative in reporting their finances. The low application of accounting conservatism is thought to be caused by the governance mechanism and CSR activities not running optimally. Effective corporate governance will support the application of accounting conservatism and the role of supervision will be maximized so that it will curb the practice of accounting manipulation (Caskey & Laux, 2017). Meanwhile, as an embodiment of the integration of CSR values, the company will increase transparency and accountability, especially in presenting reports to stakeholders and shareholders regarding the company's activities so that these demands will direct the company to present quality reports including profit reports and CSR so that it will support the implementation of accounting practices. conservatism (Cheng & Kung, 2016). Meanwhile, in Indonesia itself, governance and CSR mechanisms are still not effective and efficient so that this also affects the practice of implementing accounting conservatism to be lower and has an impact on earnings management practices, especially financial statement manipulation. The next possibility is the low value of R-Squares or the contribution of corporate governance and CSR variables showing a value of 2.7% and the Q-Squares value showing a value of 0.060 where the predictive power of the governance and CSR variables is very weak against accounting conservatism. (see table 3).

#### 5. CONSLUSION, SUGGESTION, AND LIMITATION

This study analyzes and explains the influence between governance mechanisms and corporate social activities in relation to minimizing earnings management practices through the application of conservative financial reporting practices in Indonesian state-owned companies. Weak governance mechanisms in Indonesia have an impact on the effectiveness or role of the company's board of commissioners in carrying out their function as supervisors of the performance of company management. In addition, although social activities in state-owned companies are the top priority after profit, CSR practices themselves are not fully implemented optimally. Some evidence shows that the involvement of state-owned companies in misappropriating CSR funds makes CSR practices that should be able to promote ethical values to

become unethical. The ineffectiveness of these two mechanisms is proven to reduce the level of application of accounting conservatism practices due to weak supervision and the intrinsic value contained in CSR activities cannot be integrated into the company's management behavior patterns so that this will encourage management to engage in earnings management practices. In addition, the compensation motive is thought to be the classic reason why company management in Indonesia is motivated to manipulate earnings using the profit-increasing method.

Combining our findings and the latest literature, corporate governance and corporate social activities must be practiced and continuously controlled for quality and in connection with this research it is mandatory to evaluate and correct errors in their implementation practices. Both of these mechanisms will be very effective and powerful as indicators that can improve the quality of company profits and can be used as a very important strategy for the benefit of SOE enterprises. The collaboration between these two mechanisms and the practice of accounting conservatism is considered sufficient to balance the two goals of state-owned companies and namely the goals of profit and corporate social care. considering our empirical results, in future research we suggest considering compensation as one of the indicators that determine the main motivation of management to engage in earnings management practices. In addition, the necessary limits are needed to evaluate the extent of improvement that must be made by state-owned companies to maximize the role of governance and CSR in relation to improving accounting conservatism practices that are still applied at a low level.

The author realizes that there are research limitations found at the time of this study, including in this study, researchers used the GRI G4 guidelines as a measuring tool to assess CSR disclosure in Indonesia, so that companies in Indonesia did not have uniformity in reporting CSR activities. This has an impact on the number of samples selected, because the companies listed on the IDX in particular do not all use the GRI G4 standard in disclosing CSR activities. In addition, the results of this study may contain a bias towards companies that do not issue

with the same standards, so they cannot be generalized to different companies.

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