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The effect of corporate governance on earnings management moderated by political connection

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Abstract

Research aims: This research aims to prove the effect of independent commissioner performance and audit committee expertise on earnings management to avoid earnings decreases and political connections to strengthen independent commissioner performance and audit committee expertise to limit earnings management.

Design/Methodology/Approach: The population was manufacturing firms listed on Indonesian Stock Exchange during 2017-2020. The sampling technique used purposive sampling with a sample of 102 firms for four years or 408 observations. Then, hypothesis testing employed multiple regression analysis and hierarchical regression analysis.

Research findings: The results showcased that accrual earnings management and abnormal discretionary expenses were used by managers to avoid decreases in earnings. On the other hand, corporate governance, like audit committee expertise, could be used to limit earnings management. While the political connection could strengthen and weaken the effect of independent commissioner performances in limiting earning management, political connections could not strengthen audit committee expertise in limiting real and accrual earnings management.

Theoretical contribution/Originality: This research contributes to the political connection and earning management literature and provides empirical evidence of agency theory, positive accounting theory, prospect theory, and resource dependence theory.

Practitioner/Policy implication: This research contributes to investors in determining investment decisions.

Research limitation/Implication: The limitation of this research is that independent variables only used two components of corporate governance, i.e., the independent commissioner performances and audit committee expertise, so the level of influence of the independent variables on the dependent was small.

Keywords: Earnings management; Earning decreases; Corporate governance; Independent commissioner performance; Audit committee expertise; Political connections

Introduction

In Indonesia, many companies do earnings management, as in the research conducted by Sunan et al. (2021), Pratiwi and Wirama (2020). For instance, PT Tiga Pilar Sejahtera Food Tbk increased its earnings in

2017 by IDR 4 trillion by conducting earning management. It is evidenced by KAP Ernest and Young's investigation that the company inflated the value of trade receivables, inventories, and fixed assets (Wareza, 2019).

Among several groups of companies, manufacturing companies carry out earnings management since they have large business risks and are less regulated (Pratama & Devi, 2021). It is evident from several cases of earnings management in manufacturing companies like Kimia Farma, PT Toyota, PT Tiga Pilar Sejahtera Food Tbk, and PT Krakatau Steel Tbk (Pratama & Devi, 2021). Related to that, Burgstahler and Dichev (1997) found that managers are motivated to do earnings management to get earning targets: 1) to avoid reporting losses; 2) to avoid earning decreases from the previous year; and 3) to get earning forecasts from analysts. Managers must get earning targets because managers have pressure to give investors expectations of good performance reflected in increased company earnings (Azmi et al., 2022).

Specifically, one of the managers' motivations for managing earnings is to avoid earning decreases. Since the manager's performance is reflected in the company's earnings, managers avoid earning decreases (Degiannakis et al., 2019). The decreased company's earnings from the previous period indicate that the manager's performance was poor, which resulted in a negative signal to stakeholders so that the company would pay more costs in transactions with stakeholders (Burgstahler & Dichev, 1997). Besides, decreased earnings prevent managers from getting bonus compensation for their performance (Scott, 2015). Therefore, to cover up the manager's deficient performance and get the bonus, managers with opportunistic nature will exaggerate the performance results by doing earnings management. Managers can use both real and accrual activities to achieve earning targets (Wijoyo & Firmansyah, 2021).

Earnings management occurs because of differences in interest between managers and shareholders. It is explained in agency theory that each individual has different motivations based on personal interests; it creates conflicts of interest between principals and agents (Jensen & Meckling, 1976). Consequently, earning management makes financial reports not transparent enough and reduces the quality of earnings performance, making stakeholders' decisions less accurate (Lateef et al., 2019; Nugraha, 2021). Hence, earning management should be limited.

In this regard, corporate governance can be used to minimize earnings management because it makes financial reports more transparent. Al-Khonain and Al-Adeem (2020) also stated that the quality and transparency of financial reports are determined by corporate governance. The corporate governance used is independent commissioners' performances and audit committee expertise.

The board of commissioners has a monitoring function per its duties. It supervises the firm's management and advises the directors (Syafa'ah, 2021). The board of commissioners consists of independent board commissioners, board commissioners from shareholders, and board commissioners from the firm. Since independent commissioners do not have conflicts of interest in carrying out their duties, they can conduct their

supervisory functions more effectively, including monitoring the quality of financial reports (Pratami et al., 2021). An audit committee is also needed to minimize earnings management. The audit committee oversees and monitors financial reports and ensures that the published financial reports reflect the company's actual state (Namakavarani et al., 2021). Therefore, the audit committees must understand financial reports and have knowledge, experience, and abilities related to their duties. Based on this, the audit committee must have competency in accounting or finance to carry out their duties effectively. Dewi and Mita (2019) and Al-Absy et al. (2020) found that audit committees with financial and accounting educational backgrounds can reduce earnings management.

Nevertheless, previous research on the effect of independent commissioner performance and audit committee expertise gives inconsistent results. Some previous research found that the independent board of commissioners and audit committee expertise can reduce earnings management (Mardjono & Chen, 2020; Manurung & Syafruddin, 2020; Mardessi & Fourati, 2020; Shaqila, 2021; Galal et al., 2022). Meanwhile, another research uncovered that an independent board of commissioners and audit committee expertise could not reduce earnings management (Rucita & Sanjaya, 2021; Handayani & Ibrani, 2020; Marcelina, 2020; Dewi & Mita, 2019). The inconsistent research results regarding the effect of independent commissioner performance and audit committee expertise on earnings management made the current researchers add moderating variables. The researchers suspect that previous studies did not use other variables to interact with the effect of independent variables on the dependent variable. Hence, the researchers used political connections as a moderating variable. The researchers used political connections because, based on theory and previous research, political connections can strengthen the effect of corporate governance to reduce earning management.

Moreover, resource dependence theory explains that politicians on the board are strategic governance that can reduce uncertainty from the company's external environment, especially the government (Supatmi et al., 2019). Because political connections are a good corporate strategy to minimize external environmental uncertainties, particularly from the government, and ultimately improve company performance, political connections positively affect companies. Harianto (2022) and Khalil et al. (2022) have proven that political connections could reduce earnings management. Ang (2012) also confirmed that independent boards with political connections could positively contribute to the company, minimizing earnings management.

Further, this research's novelty lies in its use of the political connection as the moderating variable and proof that it can strengthen independent commissioner performance's effect on lowering earnings management accruals. As a result, this research adds to the body of knowledge on political connections. This study also uses earnings management focusing on avoiding earning decreases and proving that managers use actual and accruals earnings management. Hence, this research contributes to earning management literature. Moreover, previous research has mostly measured independent commissioners using their proportions rather than their performance; nonetheless, this research measured independent commissioners using their performance, making it a

novel instrument for independent commissioner performance. Besides that, this research benefits investors by enabling them to make more prudent investment decisions in light of the results. Investors must also pay attention to the independent commissioner's performances, audit committee expertise, and firms' political connections to avoid the possibility of investing in loss.

Literature Review and Hypotheses Development

Agency Theory

As a pioneer of agency theory, Jensen and Meckling (1976) state that in agency theory, there is a separation of ownership and control of the company. Agency theory explains the agency relationship between the principal and the agent, in which the principal party gives the authority to manage the company while the agent party manages the company (Eisenhardt, 1989). Agency theory also elucidates the problems that arise because various parties have different motivations based on personal interests; it creates conflicts of interest between principals and agents (Jensen & Meckling, 1976). In addition, Scott (2015) asserts that good corporate governance could reduce information asymmetry between agents and principals and lower agency conflict.

Positive Accounting Theory

Positive accounting theory aims to explain and predict a phenomenon. Phenomena exist first, and then the theory is born from these phenomena. Positive accounting theory also arises because of the inability of normative theory to test theory empirically. Positive accounting theory explains the various policy choices by managers for their interests so managers can maintain their prosperity (Watts & Zimmerman, 1978). Positive accounting theory also explicates how economic factors motivate managers to choose accounting policies. Managers will choose the most optimal accounting policies that can benefit them. Further, Watts and Zimmerman (1986) describe three hypotheses that cause managers to choose an accounting policy: bonus plan, debt covenant, and political cost hypotheses. This theory was also used in previous research by Wijoyo and Firmansyah (2021), Sari et al. (2021), Vigim and Widyaningsih (2020).

Prospect Theory

Prospect theory explains how investors make decisions when choosing various risks. Investors anticipate gains and losses based on their preferences (Kahneman & Tversky, 1979). The prospect theory also describes that the decisions made by investors are related to gains or losses seen from a reference point, i.e., zero point. In this case, shareholders observe an increase in earnings around the reference point, around zero change in earnings and zero profit rate. Hence, this research used prospect theory to distinguish firms suspected of doing earnings management to avoid earnings decreases and those that did not. This research also employed zero earnings as a reference point. This theory

was utilized in previous research by Burgstahler and Dichev (1997), Degiannakis et al. (2019), Tran and Duong (2020).

Resource Dependence Theory

The resource dependence theory initiated by Pfeffer and Salancik is based on an open organizational system that sees companies as dependent on external organizations (Hillman, 2005). Pfeffer and Salancik also consider organizations to be limited and influenced by their environment, and organizations try to manage resource dependence by setting up various arrangements between organizations (Supatmi et al., 2019). To obtain resources (financial, physical, and information), companies need a strategy that considers all existing entities in the surrounding, including the government. Moreover, Supatmi et al. (2019) cited five strategies proposed by Pfeffer and Salancik to minimize environmental dependence: 1) mergers, 2) joint ventures, 3) interlocking directorates, 4) political action, and 5) executive succession. Furthermore, resource dependency theory regards boards as human capital (experience, expertise, and reputation) and relational capital, like connections with other firms and political connections (Hillman & Dalziel, 2003). This theory was used in previous research by Supatmi et al. (2019).

Hypotheses Development

Managers are motivated to manage earnings to avoid decreases (Burgstahler & Dichev, 1997). Burgstahler and Dichev (1997) stated that decreased company earnings from the previous period indicated that the manager's performance was bad, which gave negative signals to stakeholders so that companies would pay more costs in transactions with stakeholders. Earnings decrease also means managers do not get a bonus, so to get a bonus, manager increases earnings through earnings management (Sari et al., 2021; Vigim & Widyaningsih, 2020). Moreover, bad manager performance also affects a manager's reputation. Therefore, to maintain their reputation, managers manage earnings to avoid earning decreases so that earnings suit shareholders' expectations (Scott, 2015). Degiannakis et al. (2019), Tran and Duong (2020) found that managers did earning management to avoid earning decreases. In this regard, earnings management used by managers can be real earnings management and accrual earnings management. Based on this explanation, the following research hypotheses were formulated:

H₁: Firms do earnings management to avoid earning decreases.

Agency theory elucidates that earnings management is influenced by conflicts of interest between agents and principals because each party wants to achieve its goals (Scott, 2015). In this case, independent commissioners are one of the important corporate governances that limit earnings management. They monitor the company's accounting system by ensuring managers use relevant accounting principles and standards in preparing financial reports, ensuring the credibility of accounting information (Githaiga et al., 2022). Hence, the board of commissioners can limit earnings management, especially independent commissioners. Since independent commissioners do not have conflicts of interest in

doing their duties, they can do their supervisory functions more effectively, including monitoring the quality of financial reports (Pratami et al., 2021). Putri and Supatmi (2022) showed that the board of commissioners had a negative effect on real earnings management as measured by abnormal production costs. Manurung and Syafruddin (2020) also found that independent commissioners could reduce earning management accrual. In addition, Shaqila (2021) demonstrated that independent commissioners had a negative effect on earnings management. Based on this explanation, the research hypotheses below were derived:

H₂: Independent commissioner performances have a negative effect on earnings management.

Furthermore, the audit committee's duty is to review the financial information that the company will issue to the public so the financial report information has higher quality and reliability (Asikin et al., 2022). The audit committee can carry out its duties more effectively if it understands the company's financial statements and has the knowledge, experience, and capabilities in accounting and finance. Mardjono and Chen (2020), Manurung and Syafruddin (2020), and Galal et al., 2022) revealed that audit committees with financial or accounting educational backgrounds and audit committee members with experience in financial institutions could reduce earnings management. Based on this explanation, the research hypotheses were put forward as follows:

H₃: Audit committee expertise has a negative effect on earnings management.

The effect of corporate governance on earnings management can be strengthened by political connections. Related to that, the resource dependence theory explains that politicians on the board are strategic corporate governance that can reduce uncertainty from the company's external environment, especially the government (Hillman, 2005). Khalil et al. (2022) also asserted that politicians could help protect companies from legal interference, market penalties, and scrutiny. However, many corruption cases by state officials make companies and company officials with political connections be noticed and observed by the public. Based on that, boards with political connections will do their duties more thoroughly to avoid earning management, especially independent commissioners, because they do not have conflicts of interest. If the public knows the company is doing earning management, the reputation of the boards will be blackened. Politicians who serve on corporate boards will also carry out their duties strictly and responsibly to maintain their reputation since they maintain the political relationship's privileges with the government (Savitri, 2021; Khalil et al., 2022). Harianto (2022) and Khalil et al. (2022) uncovered that political connections could reduce earning management. Based on this explanation, the research hypotheses were put together:

H₄: Political connection strengthens the negative effect of independent commissioner performances on earnings management.

Additionally, the presence of politicians on the board can provide benefits to companies, such as information on public policy processes, connections to other politicians, and access to policymakers (Hillman, 2005). Politically connected boards will also reduce transaction costs, increase corporate resilience, and are proven to expedite corporate business transactions (Supatmi et al., 2019). Therefore, political connections can provide financial and non-financial benefits for companies that make the company’s performance better. Good company performance will increase company earnings, so managers do not need to do earnings management to avoid decreases. It is proven by Ika et al. (2021) that corporate governance and member of the company with political connections can increase company value. Harianto (2022) and Armadiyanti and Iswati (2019) also unveiled that member companies with political connections had good audit quality, reducing earning management. Based on this explanation, the formulated research hypotheses are:

H₅: Political connection strengthens the negative effect of audit committee expertise on earnings management.

Based on the hypotheses development, the research framework is as follows (Figure 1).

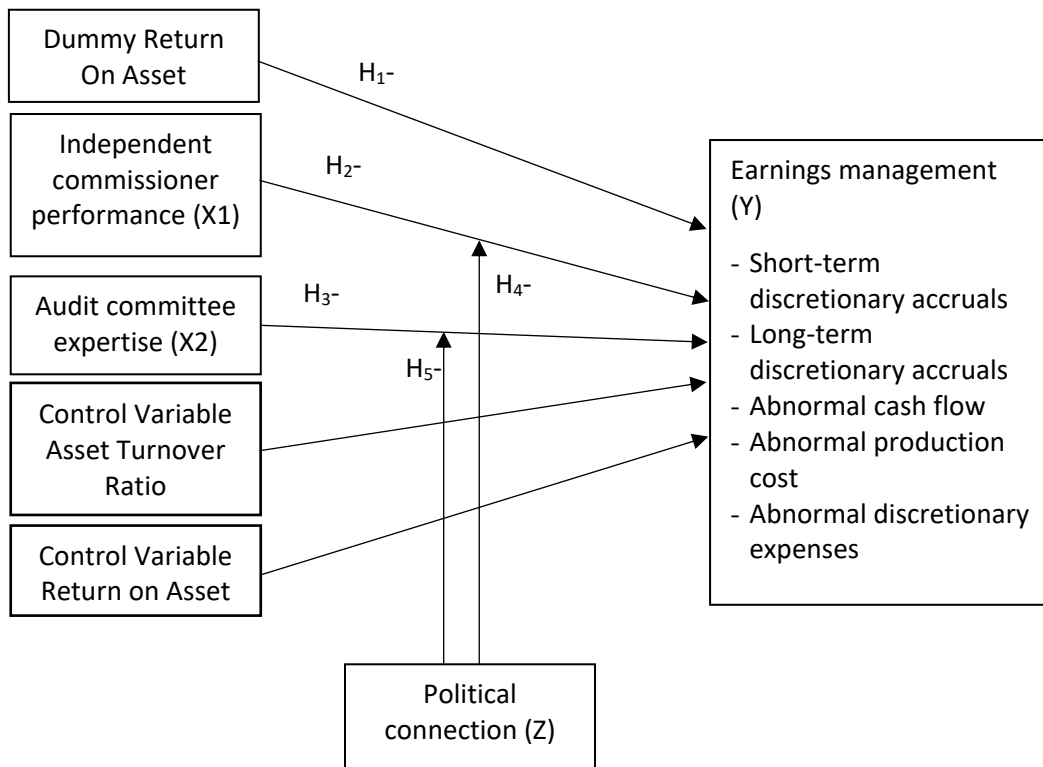


Figure 1 Research Model

Research Method

This research examined the effect of independent commissioner performances and audit committee expertise on earnings management to avoid earnings decreases and the effect of political connections to strengthen the negative effect of independent commissioner performance and audit committee expertise on earnings management. This research used a quantitative approach with a positive paradigm. This type of research was explanatory research with causal purposes. The population was manufacturing companies listed on Indonesia Stock Exchange during 2017-2020. The sampling technique employed purposive sampling with judgment sampling type. The sample criteria used included 1) manufacturing firms listed on the Indonesia Stock Exchange during 2017-2020 with complete annual reports, 2) firms that used rupiah currency in financial reports, and 3) firms with complete information recommendations from the board of commissioners, the educational background of the audit committee, and complete information profiles the board of commissioners and the board of directors. Based on these criteria, 102 companies were obtained as research samples with 408 observations for four years (2017-2020).

In this research, earnings management was the dependent variable. In fact, earnings management uses accrual earnings management and real earnings management. Accrual earnings management employed two proxies, i.e., short-term discretionary accruals and long-term discretionary accruals from Kothari (2005). Meanwhile, real earnings management utilized three proxies: abnormal cash flow from operations; abnormal production costs; and abnormal discretionary expenses following Roychowdhury (2006). In addition, five model earnings management proxies modified by Subekti (2012) are in accordance with Indonesian conditions.

$$\text{SHORTDA} = \text{STACct}/\text{At-1} - [\alpha_1 (1/\text{Log At-1}) + \alpha_2 ((\Delta\text{REVt} - \Delta\text{ARt})/\text{At-1}) + \alpha_3 (\text{INct}/\text{At-1})] \dots (1)$$

$$\text{LONGDA} = \text{LTACct}/\text{At-1} - [\alpha_1 (1/\text{Log At-1}) + \alpha_2 (\text{PPEt}/\text{At-1}) + \alpha_3 (\text{INTt}/\text{At-1}) + \alpha_4 (\text{INct}/\text{At-1})] \dots (2)$$

$$\text{ABNCFO} = \text{CFOt}/\text{At-1} - [\alpha_0 + \alpha_1 (1/\text{Log At-1}) + \alpha_2 (\text{St}/\text{At-1}) + \alpha_3 (\Delta\text{St}/\text{At-1})] \dots (3)$$

$$\text{ABNPROD} = \text{PRODt}/\text{At-1} - [\alpha_0 + \alpha_1 (1/\text{Log At-1}) + \alpha_2 (\text{St}/\text{At-1}) + \alpha_3 (\Delta\text{St}/\text{At-1}) + \alpha_4 (\Delta\text{St-1}/\text{At-1})] \dots (4)$$

$$\text{ABNDISCR} = \text{DISCRt}/\text{At-1} - [\alpha_0 + \alpha_1 (1/\text{Log At-1}) + \alpha_2 (\text{St}/\text{At-1})] \dots (5)$$

Where α is for Regression coefficient; SHORTDA for Short-term discretionary accruals in year t; At-1 for Total asset in year t-1; STACct for Short-term accrual in year t; ΔREVt for Revenue year t less year t-1; ΔARt for Account receivable year t less year t-1; ΔINct for Net income year t less year t-1; LONGDA for Long-term discretionary accruals in year t; LTACct for Long-term accrual in year t; PPEt for Plant, property, and equipment in year t; INTt for Intangible assets in year t; INct for Net income in year t; ABNCFO for Abnormal cash flow from operation; CFOt for Cash flow from operation in year t; ABNPROD;

Abnormal production cost; $PROD_t$ for Production cost in year t ; $ABNDISCR$ for Abnormal discretionary expense; $DISCR_t$ for Discretionary expense in year t ; St for Sales in year t ; ΔSt for Sales in year t minus year $t-1$; and $\Delta St-1$ for Sales in year $t-1$ minus $t-2$.

The independent variables of this research were independent commissioner performances and audit committee expertise. Independent commissioners are members of the board of commissioners who come from outside the company and fulfill the requirements as independent commissioners. Independent commissioner performance was measured using recommendations from the board of commissioners (Shaqila, 2021).

$$ICP = \frac{\text{Total Board of Commissioners' recommendations}}{\text{Total recommendations according to OJK rules}} \dots\dots\dots (6)$$

Meanwhile, the audit committee is formed by the board of commissioners and is responsible to the board of commissioners to assist them in performing their duties and functions. The measurement of audit committee expertise is as follows.

$$ACE = \frac{\text{Total audit committee with a financial background}}{\text{Total of the audit committee}} \dots\dots\dots (7)$$

Then, the political connection was the moderating variable. Political connections were determined using the political connection score index (PCIDX) from Supatmi et al. (2019), adapted to the Indonesian condition. The score of political connections was measured by adding up the score of political connections based on position and status. The scoring would differentiate between politically connected personnel still active during the research period and those no longer active. Politically connected personnel who were still active were given a higher score than those who were no longer active. Personnel politically connected who were still active were given a score between 2 (lowest) to 9 (highest), while personnel who were no longer active would be given a score between 1 (lowest) to 8 (highest). Besides, a zero score was given if the company had no political connections.

Moreover, the control variables in this research were asset turnover ratio (ATR) and return on assets (ROA). Asset turnover ratio is an activity ratio that measures a company's ability to generate sales from total assets. The measurement of the asset turnover ratio is as follows.

$$ATR = \frac{\text{Total Sales}}{\text{Total Asset}} \dots\dots\dots (8)$$

On the other side, return on assets is a financial ratio used to measure a company's performance earnings compared to total assets owned. The measurement of return on assets is as follows.

$$ROA = \frac{\text{Income}}{\text{Total Asset}} \dots\dots\dots (9)$$

Afterward, the samples were divided into firms suspected of doing earnings management to avoid earnings decreases and firms not suspected of doing earnings management to avoid earnings decreases (Table 1). Firms suspected of doing earnings management to avoid earnings decreases were those with ROA bigger than zero but less than equal to 5% compared to the previous year's ROA ($ROA_{t-1} < ROA_t \leq ROA_{t-1} \times 5\%$). Besides, the limitation rate using 5% refers to research by Roychowdhury (2006). In addition, firms suspected of doing and not doing earnings management used dummy variables. Firms suspected of doing earnings management were given 1, while firms not suspected of doing earnings management were given 0.

Table 1 Identification Firms Suspected Doing Earnings Management

| Year | Suspected | Unsuspected |
|-------|-----------|-------------|
| 2017 | 6 | 96 |
| 2018 | 5 | 97 |
| 2019 | 5 | 97 |
| 2020 | 5 | 97 |
| Total | 21 | 387 |

Data analysis was carried out step by step. The first step was that the researchers distinguished between firms suspected of doing earnings management to avoid earnings decreases and firms that did not. In the next step, the researchers examined how managers would use accrual or real earnings management to avoid earnings decreases. This test will provide empirical evidence of methods used by managers to manage earnings to avoid earnings decreases. Afterward, the effect of independent commissioner performances and audit committee expertise on earnings management was investigated using significant earnings management proxies used by the managers to avoid earnings decreases. The last step was to scrutinize the effect of political connections to strengthen the negative effect of independent commissioner performances and audit committee expertise on earnings management.

Furthermore, this research used multiple linear regression analysis to test hypothesis 1: firms doing earnings management to avoid earnings decreases, proxied by short-term discretionary accruals, long-term discretionary accruals, abnormal cash flow from operations, abnormal production costs, and abnormal discretionary expenses. Hypothesis 1 is supported if the regression model equation 1 sign is at $\alpha < 5\%$ and the value of $\beta_1 \neq 0$. The regression model of this research is as follows (Model 10):

$$EM = \alpha + \beta_1 Dm_ROA + \beta_2 ATR + \beta_3 ROA + \epsilon_t \dots\dots\dots (10)$$

Where α is for Constant; β for Regression coefficient; EM for Earning management, proxied by short-term discretionary accruals, long-term discretionary accruals, abnormal cash flow from operation, abnormal production cost, and abnormal discretionary expense ; Dm_ROA is Dummy ROA (1 for the sample identified as doing earning management and 0 for the sample not identified as doing earning management); ATR for Asset Turnover Ratio; and ROA for Return on Asset.

Then, this research utilized hierarchical multiple regression analysis to test hypotheses 2-5, i.e., the effect of independent commissioner performances and audit committee expertise on earnings management proxied by short-term discretionary accruals, long-term discretionary accruals, abnormal cash flow from operations, abnormal production costs, and abnormal discretionary expenses. Subsequently, the effect of independent commissioner performances and audit committee expertise on earnings management was analyzed using proxies (short-term discretionary accruals, long-term discretionary accruals, abnormal cash flow from operations, abnormal production costs, and abnormal discretionary expenses) with political connection as the moderating variable. In this case, hypotheses 2 and 3 are supported if the hierarchical model equation stage 1 sign is at $\alpha < 5\%$, and the value of β_1 and β_2 is < 0 . Hypotheses 4 and 5 are supported if the hierarchical model equation stage 3 sign is at $\alpha < 5\%$, and the value of β_6 and β_7 is < 0 . The hierarchical model of this research is as follows:

$$EM = \alpha + \beta_1 ICP + \beta_2 ACE + \beta_3 ATR + \beta_4 ROA + \epsilon \dots\dots\dots (11)$$

$$EM = \alpha + \beta_1 ICP + \beta_2 ACE + \beta_3 ATR + \beta_4 ROA + \beta_5 PC + \epsilon \dots\dots\dots (12)$$

$$EM = \alpha + \beta_1 ICP + \beta_2 ACE + \beta_3 ATR + \beta_4 ROA + \beta_5 PC + \beta_6 ICP * PC + \beta_7 ACE * PC + \epsilon \dots\dots (13)$$

Where α is for Constant; β for Regression coefficient; EM for Earning management with proxies of short-term discretionary accruals, long-term discretionary accruals, abnormal cash flow from the operation, abnormal production cost, and abnormal discretionary expense; ICP for Independent commissioner performances; ACE for Audit committee expertise; PC for Political connections; ATR for Asset Turnover Ratio; ROA for Return on Asset; ϵ for Error term.

Results and Discussion

The descriptive statistical analysis showed data distribution characteristics, such as the minimum value, maximum value, mean, and standard deviation.

Table 2 Descriptive Statistic

| | Mean | Min | Max | Std.dev |
|-----------------------------|----------|--------|-------|---------|
| SHORTDA | 0.025 | -0.501 | 0.435 | 0.092 |
| LONGDA | -0.201 | -1.075 | 0.741 | 0.122 |
| ABNCFO | -0.003 | -0.383 | 0.866 | 0.108 |
| ABNPROD | 3.380E-5 | -0.930 | 0.550 | 0.245 |
| ABNDISCR | 3.037E-8 | -0.294 | 0.684 | 0.134 |
| DUMMY_ROA | 0.052 | 0 | 1 | 0.221 |
| ICP | 0.387 | 0 | 1 | 0.293 |
| ACE | 0.816 | 0.333 | 1 | 0.213 |
| PC | 2.147 | 0 | 28 | 4.559 |
| ATR | 0.970 | 0.006 | 6.333 | 0.632 |
| ROA | 0.051 | -1.050 | 0.921 | 0.128 |
| Number of observations: 408 | | | | |

The descriptive statistics for each variable are shown in Table 2. Total short-term discretionary accrual, long-term discretionary accruals, abnormal cash flow from operations, abnormal production costs, abnormal discretionary expense, dummy ROA, political connections, and return on assets revealed the variation of minimum and maximum data. It can be seen that the mean value was smaller than the standard deviation value. As for performance, independent commissioners, audit committee expertise, and asset turnover ratio, they had minor minimum and maximum data variations. It can be observed from the deviation standard being smaller than the mean. The results of multiple linear regression analysis are presented in Table 3. The F-test results uncovered that all earnings management models with proxies of SHORTDA, LONGDA, ABNCFO, ABNPROD, and ABNDISCR were significant, so every earnings management model was good and could be used to predict the dependent ...

Table 3 The Results of Multiple Linear Regression Analysis

| | SHORTDA | LONGDA | ABNCFO | ABNPROD | ABNDISCR |
|-------------------------|---------------------|-----------------------|----------------------|-----------------------|---------------------|
| Constant | 0.021 (2.531) | -0.157 (-14.508) | -0.010 (-1.183) | 0.014 (0.678) | -0.018 (-1.494) |
| DUMMY _ROA | 0.033* (1.609) | -0.052** (-1.963) | 0.018 (0.812) | -0.006 (-0.121) | 0.059** (1.971) |
| ATR | -0.002 (-0.272) | -0.039*** (-4.144) | -0.013** (-1.696) | 0.031** (1.757) | 0.008 (0.775) |
| ROA | 0.094*** (2.594) | -0.063* (-1.347) | 0.375*** (9.678) | -0.849*** (-9.630) | 0.136*** (2.575) |
| F-value | 3.354*** | 9.281*** | 31.996*** | 31.145*** | 4.482*** |
| Adjusted R ² | 0.017 | 0.058 | 0.186 | 0.182 | 0.025 |
| * Sig at α = 10% | | ** sig at α = 5% | | *** sig at α = 1% | |

As displayed in Table 3, earnings management uses five proxies, so the results of earnings management more detail. The coefficient of Dummy_ROA for the SHORTDA proxy was 0.033 with a t-value of 1.609, significant at the 10% level. Since the coefficient of Dummy_ROA for LONGDA proxy was -0.052 with a t-value of -1.963 significant at 5%, Then, the coefficient of Dummy_ROA for the ABNDISCR proxy was 0.059, and the t-value of 1.971 was significant at the 5% level. These results reinforced hypothesis 1, proposing that managers did earnings management to avoid earning decreases by SHORTDA, LONGDA and ABNDISCR proxy. In addition, Dummy_ROA for earnings management with ABNCFO proxy had a t-value of 0.812, and with ABNPROD proxy had a t-value of -0.121, which were insignificant. It implies that managers did not manage earnings to avoid earning decreases on real transactions, such as operating cash flow and production costs.

This research is corroborated by previous research by Burgstahler and Dichev (1997) and Degiannakis et al. (2019). The results also agree with Burgstahler and Dichev (1997), finding that 8-12% of companies with small earnings decreases did earnings management to increase earnings. In addition, this finding strengthens the prospect theory that managers are related to profits or losses seen from a reference point, namely a zero point (Kahneman & Tversky, 1979). Further, this research confirms the positive accounting theory that managers manage earnings to avoid earning decreases to get bonuses.

Previous studies by Sari et al. (2021) and Vigim & Widyaningsih (2020) also reinforce this research.

Managers manage earnings to avoid decreases by increasing short-term discretionary accruals, decreasing long-term discretionary accruals, and increasing abnormal discretionary expenses. The firms decrease long-term discretionary accruals, such as reducing the estimated loss of uncollectible accounts, so the number of receivables the company owns from sales is higher, making the firm's earnings high. Also, the firms do earnings management by increasing discretionary expenses. Firms increase discretionary expenses because discretionary expenses can greatly impact firm value in the future (Roychowdhury, 2006). Increasing R&D costs at this time will also impact the company's future competitiveness. Since the increase in discretionary expenses affects the company's ability to innovate for the benefit of the company, the company will be able to compete and increase sales (Simamora, 2019; Simamora et al., 2022).

However, the research found that the dummy ROA was insignificant in earnings management with ABNCFO and ABNPROD proxies. These results do not support previous research by Burgstahler and Dichev (1997) and Roychowdhury (2006). Some reasons why managers did not do ABNCFO and ABNPROD proxies were to avoid earning management. Managers did not do earnings management to avoid earning decreases by increasing production costs. If managers do earnings management by increasing production costs, such as producing more goods than needed, the company also requires a wider storage space, which will burden the company (Simamora, 2019). Therefore, managers did not use the method of earnings management by increasing production costs to avoid earning decreases.

The hypothesis test results also demonstrated that managers did not do earnings management to avoid earning decreases by increasing cash flow. It was because if managers increased cash flow by giving discounts, it would have a detrimental effect on the company in the future. When the company does not give discounts anymore, customers will think the price of the company's products is too high compared to before (Simamora, 2019; Simamora et al., 2022). Thus, managers did not use the method of earnings management by increasing cash flow to avoid earning decreases.

Based on the results, the next step was analysis using earnings management with the proxies of SHORTDA, LONGDA, and ABNDISCR.

The results of hierarchical regression analysis are illustrated in Table 4. The F-test results revealed that all earnings management models were significant, so each was good and could be used to predict the dependent variable.

Table 4 The Results of Hierarchical Regression Analysis

| | SHORTDA | | LONGDA | | ABNDISCR | |
|---|-----------|--------|-----------|--------|----------|--------|
| | B | t | B | t | B | t |
| Stage 1 Hierarchical Model | | | | | | |
| Constant | 0.015 | 0.900 | -0.134 | -4.634 | 0.039 | 1.215 |
| ICP | -0.006 | -0.475 | -0.023 | -1.087 | -0.001 | -0.048 |
| ACE | 0.015 | 0.893 | -0.018 | -0.622 | -0.062** | -1.934 |
| ATR | -0.015*** | -2.605 | -0.040*** | -4.112 | 0.007 | 0.658 |
| ROA | 0.302*** | 8.000 | -0.061 | -1.256 | 0.139*** | 2.570 |
| F-value | 16.462*** | | 5.905*** | | 3.084*** | |
| Adjusted R ² | 0.139 | | 0.048 | | 0.021 | |
| Stage 2 Hierarchical Model | | | | | | |
| Constant | 0.019 | 1.074 | -0.123 | -4.121 | -0.005 | -0.143 |
| ICP | -0.005 | -0.366 | -0.019 | -0.881 | -0.020 | -0.887 |
| ACE | 0.011 | 0.634 | -0.029 | -0.970 | -0.015 | -0.447 |
| ATR | -0.015*** | -2.565 | -0.039*** | -4.013 | 0.004 | 0.368 |
| ROA | 0.308*** | 7.991 | -0.052 | -1.065 | 0.104** | 1.955 |
| PC | -0.001 | -0.769 | -0.003* | -1.290 | 0.012*** | 5.042 |
| F-value | 13.274*** | | 5.065*** | | 7.707*** | |
| Adjusted R ² | 0.138 | | 0.050 | | 0.079 | |
| Stage 3 Hierarchical Model | | | | | | |
| Constant | 0.020 | 1.143 | -0.136 | -4.331 | 3.121E-5 | .001 |
| ICP | -0.004 | -0.335 | -0.013 | -0.599 | -0.022 | -0.937 |
| ACE | 0.012 | 0.712 | -0.018 | -0.562 | -0.018 | -0.508 |
| ATR | -0.014*** | -2.669 | -0.039*** | -4.002 | 0.003 | 0.320 |
| ROA | 0.253*** | 6.854 | -0.027 | -0.550 | 0.083* | 1.546 |
| PC | -0.002 | -0.639 | 0.004 | 0.678 | 0.010* | 1.468 |
| ICP*PC | 0.143*** | 7.436 | -0.107*** | -3.086 | 0.094*** | 2.500 |
| ACE*PC | -0.005 | -0.954 | -0.006 | -0.703 | 6.106E-6 | 0.001 |
| F-value | 18.773*** | | 5.171*** | | 6.463*** | |
| Adjusted R ² | 0.245 | | 0.070 | | 0.089 | |
| * sig at $\alpha = 10\%$ ** sig at $\alpha = 5\%$ *** sig at $\alpha = 1\%$ | | | | | | |

The hypothesis testing 2 results were the first stage of the hierarchical regression model on the earnings management with SHORTDA proxy exhibited in Table 4. The regression coefficient was -0.006, and the t-value of -0.475 was insignificant. Then, the hypothesis results regarding earnings management with LONGDA proxy showed that the regression coefficient was -0.023, and the t-value of -1.087 was insignificant. In addition, the hypothesis results on earnings management with ABNDISCR proxy revealed that since the regression coefficient of -0.001 and t-value of -0.048 was insignificant. Based on that hypothesis 2 was not supported. It suggests independent commissioner performances could not reduce accrual and real earnings management.

Nevertheless, the results of this research do not support the research of Manurung and Syafruddin (2020) and Shaqila (2021). In other words, this result does not align with agency theory stating that earnings management practices can be minimized by corporate governance (Scott, 2015). It is also inconsistent with the statement of Pratami et al. (2021) that an independent board of commissioners, through its monitoring function, can limit earnings management. On the other hand, the results of this research reinforce the

research of Rucita and Sanjaya (2021) and Sari et al. (2021) that independent commissioners did not affect earnings management. Independent commissioner performances had no effect on earnings management, which could be due to the lack of effectiveness of independent commissioners' performance, so they could not limit earnings management. The low effectiveness of independent commissioners' performances was caused by the fact that the board has many other positions in various companies and the lack of experience as the board of commissioners.

The hypothesis testing 3 results in the first stage of the hierarchical regression model with earnings management proxy of SHORTDA yielded a regression coefficient of 0.015 and t-value of 0.839, not significant. The hypothesis earnings management proxy of LONGDA showed a regression coefficient of -0.018 and a t-value of -0.622, which were also insignificant. Thus, this research indicates that audit committee expertise had no effect on earnings management accruals, so audit committee expertise could not limit accrual earnings management.

This result does not agree with the agency theory that corporate governance can be used to minimize earnings management as it makes financial reports more transparent (Scott, 2015). Still, the results of this research verify the research of Handayani and Ibrani (2020) and Marcelina (2020). In this case, audit committee expertise did not affect accrual earnings management because there was a possibility that the company applied regulation only to fulfill the regulation, so the accounting or financial experts who were audit committee could not do their duties effectively; besides, the appointment of audit committee members in public companies is based on a close relationship with the commissioners so that even though the audit committee has the expertise, it is difficult for the audit committee to act professionally in doing their duties (Sari et al., 2021; Nelwan & Tansuria, 2019).

However, hypothesis results on the earnings management proxy of ABNDISCR showed a regression coefficient of -0.062 and a t-value of -1.934, which were significant at the 5% level, so hypothesis was supported. It implies that audit committee expertise had a negative effect on the earnings management with the ABDISCR proxy. In other words, the more audit committees have accounting and finance backgrounds and experience in finance, the more limited real earning management. The results of this research strengthen the agency theory that corporate governance, one of which is audit committee expertise, can limit managers from managing earnings. The results of this research also support the research of Mardjono and Chen (2020) and Galal et al. (2022) that audit committee experts or audit committee members with experience in financial institutions do effective monitoring to reduce earnings management. It indicates that when the audit committees understand financial reports and have the knowledge, experience, and abilities in finance, they reduce real earning management more effectively.

Further, the stage 1 hierarchical regression model of earnings management with SHORTDA proxy revealed that the adjusted R-square was 13.9%, meaning that independent commissioner performances (X1), audit committee expertise (X2), asset turnover ratio, and return on assets explained earnings management proxied by

SHORTDA (Y) by 13.9%. Then, the adjusted R-square of LONGDA proxy showed 4.8%, indicating that independent commissioner performances (X1), audit committee expertise (X2), asset turnover ratio, and return on assets explained earnings management proxied by LONGDA (Y) by 4.8%. At last, the adjusted R-square of earnings management with ABNDISCR proxy was 2.1%, denoting that independent commissioner performance (X1), audit committee expertise (X2), asset turnover ratio, and return on assets explained earnings management with the proxy of ABNDISCR (Y) by 2.1%.

The hypothesis testing 4 results, the third stage of the hierarchical regression model with earnings management proxy of SHORTDA, displayed a regression coefficient of 0.143 and t-value of 7.436, so it was significant but in the positive coefficient direction. Next, hypothesis with ABNDISCR proxy demonstrated that the regression coefficient was 0.094 with a t-value of 2.500; since it was significant but in the positive coefficient direction, hypothesis with SHORTDA and ABNDISCR proxy was not supported. It suggests that political connections weaken the effect of independent commissioner performances on reducing earnings management.

These results are not in harmony with the research-dependent theory that the presence of politicians on the board is strategic corporate governance that can reduce uncertainty from the company's external environment, especially the government (Hillman, 2005). This research also does not support previous research stating that politicians who serve on corporate boards will carry out their duties strictly and responsibly to maintain their reputation because they maintain the privileges of the political relationship with the government (Savitri, 2021; Khalil et al., 2022). Hence, this research does not reinforce studies by Harianto (2022) and Khalil et al. (2022).

Yet, it confirms the results of Putri and Supatmi (2022) that boards with political connections positively affected real earnings management with the proxy of abnormal discretionary expenses and Ahmed et al. (2022) that political connection had a positive effect on accrual earnings management. It could be caused by companies in Indonesia with an ownership structure dominated by family ownership, which the family manages, are part of the company's management, and even occupy top management positions. As a result, it makes companies in Indonesia vulnerable to the expropriation of minority shareholders so that majority shareholders prioritize their benefits and harm minority shareholders (Putri & Supatmi, 2022). Especially if the majority shareholders or company officials have political connections, the power of the majority shareholder becomes greater, and the information asymmetry between the majority and minority shareholders is greater. It makes the majority shareholder who serves on the board of commissioners to do things for his interests.

Hypothesis 4 with LONGDA proxy uncovered that the regression coefficient was -0.107 and the t-value was -3.086, which were significant at the 1% level, so hypothesis 4 LONGDA proxy was supported. It indicates that political connections strengthened the effect of independent commissioner performances on reducing earnings management. These results corroborate the resource dependence theory that boards with political connections have a positive effect on companies as they are corporate strategies to

minimize uncertainty in the external environment, especially from the government, and ultimately can improve company performance (Hillman & Dalziel, 2003). Increased company performance will cause the company not to do earnings management to avoid decreases. These results also support Savitri (2021) and Khalil et al. (2022) that politicians who serve on corporate boards will carry out their duties strictly and responsibly to maintain their reputation since they maintain the privileges of the political relationship with the government. In this regard, independent commissioners with political connections try to build and maintain their reputation in public to keep their position as politicians. It makes the independent commissioner do more detailed supervision of the company so that things such as earnings management do not occur. This research reinforces Harianto (2022), Khalil et al. (2022), and Savitri (2021).

Moreover, the hypothesis testing 5 results, the third stage of a hierarchical regression model with earnings management proxy of SHORTDA, exposed a regression coefficient of -0.005 and t-value of -0.954, not significant. Also, hypothesis testing results for the LONGDA proxy disclosed that because the regression coefficient was -0.006 and the t-value was -0.703. Finally, the hypothesis testing results on the earnings management proxy of ABNDISCR had a t-value of 0.001, which was insignificant, so hypothesis 5 was not supported. The research results denote that audit committee expertise did not affect earnings management moderated by political connections. It implies that political connections did not strengthen the effect of audit committee expertise on reducing real and accrual earnings management. These results disagree with the resource dependence theory. This result is also inconsistent with Supatmi et al. (2019), stating that politicians on the board are strategic governance, which can reduce uncertainty from the company's external environment, especially the government, and increase company performance. Besides, this result does not verify studies by Harianto (2022) and Armadiyanti and Iswati (2019) that member companies with political connections give a good quality of audit so that it can reduce earning management. Political connections did not impact audit committee expertise in earnings management, which could be due to the low number of politically connected personnel in the sample companies, with only 28% of politically connected personnel. The low number of politically connected personnel suggests that political connections could not strengthen the negative effect of audit committee expertise on earnings management.

At last, hierarchical regression model stage third with earnings management proxy of SHORTDA had an adjusted R-square of 24.5%, denoting that independent commissioner performances (X1), audit committee expertise (X2), asset turnover ratio, return on assets, and political connection (Z) could explain earnings management proxied by SHORTDA (Y) by 24.5%. Then, the adjusted R-square for the LONGDA proxy was 7%, indicating that independent commissioner performances (X1), audit committee expertise (X2), asset turnover ratio, return on assets, and political connection (Z) could explain earnings management with the proxy of LONGDA (Y) by 7%. Besides, the adjusted R-square for ABNDISCR proxy showed 8.9%, meaning that independent commissioner performances (X1), audit committee expertise (X2), asset turnover ratio, return on assets, and political connection (Z) could explain earnings management with ABNDISCR (Y) proxy by 8.9%.

Conclusion

Earnings management in this study proxied by short-term discretionary accruals, long-term discretionary accruals, and abnormal discretionary expense was used to avoid earning decreases. Good corporate governance could be used to limit earnings management, especially audit committee expertise. Audit committee expertise could reduce real earnings management with the proxy of abnormal discretionary expense. However, audit committee expertise could not lower accrual earnings management. In addition, independent commissioner performances could reduce real and accrual earning management. While political connections strengthened the effect of independent commissioner performances on reducing earning management with the proxy of long-term discretionary accruals, on the other side, political connections weakened the effect of independent commissioner performances on reducing earning management with the proxy of short-term discretionary accruals and abnormal discretionary expenses. The result also revealed that political connections could not strengthen the effect of audit committee expertise on reducing earning management.

This research provides empirical evidence of prospect theory that managers manage earnings to avoid earning decreases from the reference point, namely zero point. It also gives empirical evidence of positive accounting theory that managers do earning management to avoid earning decreases by increasing earnings to get bonuses. Based on that, research on earning management focusing on avoiding earning decrease proves that managers use real and accrual earning management to avoid earning decreases, so this research contributes to earning management literature. Further, this research strengthens empirical evidence of agency theory that corporate governance, especially audit committee expertise, can reduce earning management. This research also provides empirical evidence of resource dependence theory and confirms that political connection can strengthen the effect of independent commissioner performance on reducing earning management accrual, contributing to the political connection literature. Other than that, this research contributes to the investor; investors can be more careful to making investment decisions. Investors must also pay attention to the independent commissioner's performances, audit committee expertise, and firms' political connections to avoid the possibility of investing in loss.

The limitation of this research is that independent variables only used two components of corporate governance, i.e., the independent commissioner performances and audit committee expertise, so the level of influence of the independent variables on the dependent was small. Therefore, future researchers are expected to use more components of corporate governance, so there are higher influence levels of independent on dependent variables. This research also focused on manufacturing companies often carried out by previous studies. For that reason, future researchers can focus on companies other than manufacturing companies, such as banking.

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