Good Corporate Governance Mechanism and Earnings Management: Study on Manufacturing Companies in Indonesia Stock Exchange

by Mukhtaruddin Mukhtaruddin

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Abstract:

The main objective of this study is to obtain empirical evidence regarding the impact of good corporate governance mechanism (GCG) on the earnings management (EM) of the manufacture companies listed in Indonesia Stock Exchange (IDX) year 2009 - 2012. The samples are collected through purposive sampling method in which, 58 companies are selected as they met the inclusion criteria. This study used Friedlan Model to measure the discretionary accruals (DA). The independent variables in this study are remuneration disclosure (RD), size of board commissioners (SBC), meeting frequency meeting board of commissioners (FMBC), frequency meeting of shareholders (FMS), managerial ownership (MO), and institutional ownership (IO). Multiple regression analysis is used to analyze the data. The results show that simultaneously, the independent variables do not have a significant impact on the EM, when tested separately, the FMS has a positive and significant effect on the EM the manufacturing companies listed in IDX.

Keywords earnings management; good corporate governance mechanism; remuneration disclosure

JEL Classification: G32; M41

Introduction

The increasing number of accounting scandals that occurred in less than two years leads to GCG issues receiving an increasing attention in academic research (Stanwick and Stanwick 2010). Weak corporate governance mechanisms and the lack of transparency are seen as the trigger for the onset of the financial crisis and various accounting scandals in Asia. As a result, the shareholders request and increase in the corporate governance mechanisms (Mohamad and Sulong 2010). Some of the companies involved in accounting scandals, such as Enron, WorldCom, Marconi, Parmalat, and others have dampened investor confidence on the management team and the financial statements (Klai and Omri 2010, Gideon *et al.* 2018). Relevant parties such as Enron, WorldCom, and Merck had allegedly EM. In Indonesia, some cases of EM that have occurred among others such as PT. Kimia Farma Tbk and PT Lippo Tbk, which also involves financial reporting that triggered by manipulation (Ujiyantho and Pramuka 2007).

Indriastuti (2012) explains that EM is an interference management in the financial reporting process with the aim to provide benefits to stakeholders. Gumanti (2001) also points out that EM conducted by the management in the financial reporting process of an organization are due to the fact that they are expecting a benefit or profit from their actions. Phenomena occurred a few years ago that many companies are already doing EM. The manager was given the authority to choose the method of accounting to be applied at the company, as long as the chosen method of accounting is in accordance with Generally Accepted Accounting Principles (GAAP). The various of accounting methods provide an opportunity for managers to implement EM practices, where the manager will choose accounting methods that benefit him. According to Scott (2015), EM practices will reduce the benefits for investors. Excessive EM will lead to the financial statements, which are not disclosed honestly. When the managers excessive conduct EM, income statements give a biased viewpoint for shareholders, so that they can influence decision-making by shareholders.

Shareholders conduct monitoring of management through GCG. He and Ho (2011) study on corporate governance focuses on two main internal monitoring mechanisms. The first is a contractual mechanism to implement the compensation for the agent to align the interests of owners and agent, and the second is internal monitoring carried out by the director or directly carried out by shareholders. GCG mechanisms associated with company's internal monitoring according to He and Ho (2011) are remuneration, size of board of directors, board of directors meeting frequency, frequency of general meeting of shareholders, directors ownership and institutional ownership. Therefore, the motivation of this study is to use the mechanisms of GCG as independent variables and EM as the dependent variable of research at manufacturing companies listed in IDX period 2009-2012. The lack of effective mechanisms of GCG, in this case on the company's internal monitoring, will further expand the opportunity for managers to do EM practices. EM is done by the selection of appropriate accounting methods that are performed by using GAAP. EM leads to the manipulation of earnings or conflicting with GAAP, such as creating a fictitious transaction income or expenses, is illegal. According to Scott (2015), there are some patterns that lead management to do EM such as income maximization, income minimization, and income smoothing. Selected patterns can vary, depending on changes to contract, level of profitability, or political views.

One of the GCG mechanisms is MO (in this case, the director who is also a part of the management). If directors have an ownership, they could choose method or accounting policies to increase benefit for them. They can be engineered in the financial statements to obscure information obtained by other shareholders. They can cover some of the fraud transactions. In this case the MO is one of the factors that influence the occurrence of EM motives (Htay, Rashid, Adnan, and Meera 2012). Liu (2012) found that block shareholder (showed shareholder by non-affiliated directors) is the governance mechanisms that are not effective in preventing EM. Ujiyantho and Pramuka (2007) found MO has significant and negative effect on the discretionary accruals. Therefore, it is appropriate to use MO as one of the variables in investigating the EM practices.

Size of Board of Commissioners (SBC) is also GCG mechanisms used in this study. SBC is a fundamental internal control mechanism in a company (Honggowati *et al.* 2017). Rahman and Ali (2006) found a significant positive relationship between DA and the SBC. The greater of SBC is ineffective in performing its oversight function. Liu (2012) found EM has a positive relationship to SBC. However, Abed, Al-Attar, and Suwaidan (2011) found SBC has a negative effect on EM. Other GCG mechanism that can affect EM is IO. IO is company shares owned by the institution or agency (Indriastuti 2012). IO is one of the parties that can monitor agent as a portion of its holdings. IO will emerge supervision in improving the company's performance and will lead to an increase in the value of the company itself. High IO has power to control the actions of management. Ujiyantho and Pramuka (2007) found IO has no effect on DA. But the results of their research showed IO, MO, SBC have simultaneously affected on DA.

Remuneration is also a GCG mechanism in motivating managers to perform of EM. One of manager's motives in performing EM is to get bonus, remuneration or incentive. This study also tries to investigate the effect of disclosure of remuneration in the annual report on EM in companies listed on the Stock Exchange. Remuneration can be given as joint stock, stock options, short-term incentives, bonuses, *etc.* (Horak and Dumancic, 2009, He and Ho 2011). Weng, Tseng, Chen, and Hsu (2014) used equity-based compensation and found if managers get higher remuneration then it can increase the occurrence of EM. While the research conducted by Liu (2012) showed that the bonus does not have a significant relationship to EM.

According to He and Ho (2011), if the company made large and expensive changes in monitoring internal, but did not changes interaction and social processes among members of board of directors, a major change will not be able to control the behavior of management and protect interests of shareholders. Interaction and social process can be realized through a meeting board of directors. Therefore, involving meeting frequency of board of directors and general meeting of shareholders in this study is needed to see their effect on earnings management. González and García-Meca (2014) found frequent meeting of board of director shows the involvement of the directors in monitoring activity; they are more involved in terms of increased financial information, in which, it will reduce the occurrence of EM. Previous research related to GCG began in the 1930s that has been emphasizing on how the financial provider for companies to insure themselves gets a return on their investment. Caliskan and Icke (2010) state that according to Denis and McConnell (2003) in 1970 and 1980, many researcher emphases on governance at companies in the United States. In the early 1990s, research related to governance has done in other countries. In the beginning of the study focused on the majority of the world economy, such as in Japan, Germany and the United Kingdom. Recent research related to corporate governance is being investigated around the world, including in developing countries or markets.

Company focuses on importance of GCG to protect interests of shareholders (Ranti and Stephen, 2011). The shareholders want the highest return on investment. Hopefully with GCG can align interests of shareholders with interests of managers. In Indonesia, EM practices have occurred in the Indonesian capital market. The practice also occurs in companies listed on IDX. In the financial statements of companies, there are found many errors in the presentation. Misstatements in the financial statements can be in form of an error in the assessment of finished goods inventory, fault-recording sales, and also in the process of assessment items were rated higher than need. The effect of misstatements would cause the income statement would be overstated. Widyaningdyah (2001) found leverage has a significant influence on EM, especially external resources, such as debt that is used to finance the company. Lin (2011) suggests that if low MO, management will opportunistic to do of EM, vice versa.

RD is developed by Horak and Dumancic (2009) that analyze remuneration recommendations qualitatively, however, Weng *et al.* (2014) used equity-based compensation, and Liu (2012) used a bonus plan. SBC is developed by Rahman and Ali (2006) and Liu (2012). FMBC and FMS are developed by González and García-Meca (2014) and Al-Najjar (2012). FMS is developed by Caliskan and Icke (2010) that analyze these variables qualitatively. MO is developed by Htay *et al.* (2012) and Liu (2012), and IO is developed by Ujiyantho and Pramuka (2007). Utomo and Bachruddin (2005) found application of EM in financial reporting periods prior to the IPO. This study uses a model by Friedlan (1994) to measure DA, the same model used in the study by Utomo and Bachruddin (2005). The difference is that Utomo and Bachruddin (2005) tested the application of EM at the time and after the initial public offering, which is one and two period of observation after the initial public offering.

Effect of Remuneration Disclosure on Earnings Management

There are three hypotheses in agency theory (Scott 2015). The hypotheses are bonus plan hypothesis, debt covenant hypothesis and political cost hypothesis. In accordance with the bonus plan hypothesis, everyone including the manager wants a high bonus. If remuneration is disclosed and given to managers based on their performance, in this case shown by the company's profit, managers choose accounting policies that increase the reported profit. Weng *et al.* (2014) found that managers with higher remuneration tend to manipulate earnings. In contrast, study by Liu (2012) shows different findings compared to Weng *et al.* (2014), that the bonus plan has no significant effect on EM. Therefore, it is appropriate to believe that there is a significant influence the RD to EM.

Effect of Size of Board of Commissioners on Earnings Management

SBC is also believed to affect the occurrence of EM. SBC is seen from the number of members of the board of commissioners. The number of members of the board of commissioners can determine the effective monitoring process at the company. The more the number of commissioners, the more complex the monitoring process will be. SBC can determine the effectiveness of supervisory functions undertaken by the board of commissioners. Liu (2012) uses SBC as a control variable in his study and uses Jones and modified Jones to calculate DA. Liu (2012) finds that EM has a positive relationship to the proportion of independent commissioners and SBC. Rahman and Ali (2006) also find that there is a significant positive relationship between DA and SBC. These results indicate that the larger board size makes the internal monitoring function less effective.

González and García-Meca (2014) found that SBC created communication and coordination problems that would reduce the monitoring function, and would improve EM. Their research found that SBC positively affected EM. Abed *et al.* (2011) study results show different results with other studies. Their results show that SBC has a negative effect on EM. This means that the larger SBC, the smaller the occurrence of EM. Based on the above explanation, hypothesis formulated: there is a significant influence the sizes of the board of commissioners to EM.

Effect of Frequency Meeting of Board of Commissioner on Earnings Management

There are two internal monitoring mechanisms in GCG (He and Ho 2011). The first mechanism is a contractual mechanism, which uses compensation to adjust shareholder interests to managerial interests. The second mechanism is internal monitoring performed by the board of commissioners or directly conducted by shareholders. The board commissioners have responsibility to exercise oversight of management. Al-Najjar (2012) examines FMBC as one of the activities of the council, including their monitoring role. FMBC can limit management behavior in excessive EM practices. González and García-Meca (2014) mention that frequent meetings indicate greater active role of the board of commissioners in tasks and performing monitoring functions and reduce the occurrence of EM practices. Their research confirms that FMBC affects the occurrence of EM. Based on the above explanation, the hypothesis is: there is influence between the frequency meetings of board of commissioners on EM.

Effect of Frequency Meeting of Shareholders on Earnings Management

Internal monitoring can be done by the board of commissioners and shareholders (He and Ho 2011). Public meetings are one of the social interaction processes among shareholders of a company to support their supervisory role. With the large number of FMS can enhance the role of shareholder oversight of management, thereby limiting the management's movement in EM. Hemraj (2004) explains that the board of commissioners must perform a continuous supervisory function of the company, and shareholders have failed to carry out its oversight function and cause the audit committee to ensure that management performs their obligations more effectively. Shareholders must play a more active role by utilizing meetings or annual meetings to ensure that the board of directors or management is acting in the best interest of shareholders. This is one form of supervision that shareholders can take. The result of Hemraj (2004) study concludes that shareholders have failed to supervise and this can lead to motivation for EM in the company. Therefore, the hypothesis is: there is a significant influence between the frequencies of general meeting of shareholders to EM.

Effect of Managerial Ownership on Earnings Management

Disclosure of information is important in GCG mechanisms aims at protecting the interests of company shareholders (Htay *et al.* 2012). Disclosure is believed to be able to reduce information asymmetry, which can lead to EM. It can clarify the conflict of interest between shareholders of the company with management and make the company more accountable. If management has ownership in a company, management is the owner of the company itself. This means that management will directly provide instructions and monitor the management. Management who has substantial shareholding amounts will choose accounting policies that may affect profits to be reported for their personal gain. The variable of the director ownership in this study is developed from the study of Htay *et al.* (2012) and Liu (2012). Htay *et al.* (2012) finds that Social and Environmental Information Disclosure relate negatively to MO. That way EM has a positive influence on MO. Liu (2012) uses block shareholder variables as measured by using the ownership of shares owned by unaffiliated directors as the control variables and shows that block shareholders have no effect on EM. Based on the above explanation, our hypothesis is: there is a significant influence of director's ownership to EM.

Effect of Institutional Ownership on Earnings Management

One of the means that can supervise the EM practices is IO (Shaikh, Iqbal, and Shah 2012). IO can limit the behavior of managers. IO is an effective part of monitoring to ensure better management performance in creating value. The supervision of the institute encourages management to focus more on the company's performance, and suppress the manager's opportunistic nature. Ujiyantho and Pramuka (2007) conduct a study using percentage of IO and show that IO has no effect on EM. Therefore, our hypothesis is: there is significant influence of IO to EM.

1. Methods

1.1 Population sample

The population in this study is manufacturing companies listed on the IDX for the period of 2009 - 2012. There are 71 companies listed in manufacturing each year however only 54 companies have the complete data. Therefore, the sample of our study is 216 (54 x 4) annual reports during 2009-2012.

1.2. Variable operational definition

1.2.1 Dependent variable

EM is measured by DA. The method of calculating DA is developed by Friedlan (1994) and has been used in Utomo and Bachruddin (2005). Mathematically the total accruals can be expressed in the equation:

$$TACit = NIit - CFOit$$

where: TAC = Total Accruals Company *i* at year *t*; NIit = Net Income Company *i* at year *t*; CFOit = Cash Flows from Operation Company *i* at year *t*,

According to Utomo and Bachruddin (2005), there is a constant proportion between total accruals and sales in successive periods. This causes the total amount of accruals used to determine the magnitude of the discretionary accruals value is the difference between the total accruals in the period under review which are standardized with sales in the observation period with total accruals in the pre-standard observation period with sales in the prior period prior. Mathematically DAs in each observation period are measured by:

DAit = (TACit/SALESit) - (TACit-1/SALESit-1)

where: DAit = Discretionary Accruals Company *i* at year *t*; TACit = Total Accruals Company *i* at year *t*; SALESi = Sales Company *i* at year *t*; TACit-1 = Total Accruals Company i year t-1; SALESit-1 = Sales Company *i* year *t-1*

1.2.2 Independent variable

Remuneration disclosure

RD is developed from the study of He and Ho (2011) and Horak and Dumancic (2009), Weng *et al.* (2014) and Liu (2012) observed the effect of bonus plan on EM. Weng *et al.* (2014) shows that managers with higher remuneration tend to manipulate income. However, Liu (2012) states that bonus plan has no significant effect on EM. In this study, the disclosure of remuneration will be seen from the annual report of companies listed on IDX. Measurement of RD is done by using dummy variable. In this variable, if there is RD in the annual report then the category is 1, and if not then the category 0.

Size of boards commissioner

This variable refers to the study by Horak and Dumancic (2009), which analyze qualitatively and the research conducted by Liu (2012) that uses the SBC a control variable. The measurement used in this variable is the number of members of the board of commissioners.

Frequency meeting of board commissioners

This variable is developed from Al-Najjar (2012) and González and García-Meca (2014) that used board activity. Board activity is measured by FMBC. This variable is measured by number of board meetings held in one year.

Frequency meeting of shareholders

This variable is developed from the study of Caliskan and Icke (2010). This variable also refers to the research by He and Ho (2011), which states that one of the internal monitoring mechanisms is done by shareholders. Other studies that use FMS are those conducted by Hemraj (2004). This variable is measured using the number of shareholder general meetings held in a year.

Management ownership

MO is developed from research conducted by Htay *et al.* (2012) and Liu (2012). In this study, MO is measured by the proportion of shares held by management.

Institutional ownership

This variable is developed from Ujiyantho and Pramuka (2007). This variable is measured using the proportion of shares held by institutional.

1.3 Data analysis

This study examines the effect of GCG mechanisms and internal monitoring on EM manufacturing companies listed on the IDX 2009 - 2012 with the following models:

$$DA = \alpha 0 + \alpha 1RD + \alpha 2SBC + \alpha 3FMBC + \alpha 4FMS + \alpha 5MO + \alpha 6IO + e$$

where: DA = Discretionary Accrual (Earnings Management), RD = Remuneration Disclosure, SBC = Size of Board of Commissioner, FMBC = Frequency Meeting of Board of Commissioners, MO = Managerial Ownership, IO = Institutional Ownership.

2. Results and discussion

Based on the Table 1, the multiple regression models to EM as following equation:

$$DA = -0{,}743 + 0{,}601RD + 0{,}008SBC - 0{,}002FMBC + 0{,}190FMS - 0{,}179MO - 0{,}112IO$$

The results of the test in Table 1 show that RD, SBC, FMBC, FMS, MO and IO have a greater significance value of 0.05. These results indicate that partially RD, SBC, FMBC, MO and IO have no significant effect on EM, whereas the frequency of general meeting of shareholders has a significance of 0.002 less than 0.05. This means that FMS has a significant effect on EM.

Table 1. Result of *t* test

Variable	B	Std. Error	t	Sig.
Constant	-0.743	.620	-1.198	0.232
Remuneration Disclosure	0.601	.596	1.008	0.315
Size of Board of Commissioner	0.008	.018	0.451	0.653
Frequency Meeting of Board of Commissioner	-0.002	.003	-0.685	0.494
Frequency Meeting of Shareholders	0.190	.061	3.103	0.002
Managerial Ownership	-0.179	.732	-0.245	0.807
Institutional Ownership	-0.112	.227	0.492	0.623

2.1. Effect of remuneration on earnings management

As seen in Table 1, the significance of RD is 0.315 indicating that there is no effect of RD on EM. This result is in line with Liu (2012) that also find similar result. However, this finding is differ with those done by Weng *et al.* (2014) that RD has a positive effect on EM. Liu (2012) conducts a study on 138 companies and use Jones Model to calculate the EM and it is found that the bonus plan has no effect on EM. This result is supported by Scott (2015) that points out the three hypothesis of positive accounting theory, namely, bonus plan hypothesis, debt covenant hypothesis and political hypothesis. This shows that the occurrence of EM in the company not only influenced RD and that EM can occur due to other factors beside the RD.

According to the bonus plan hypothesis, by using remuneration, management can maximize shareholders' wealth and create value for them as they increase their performance due to the remuneration. Therefore, it is also used as an excuse by the management to do EM hope to receive the remuneration. Such disclosure may also be aligning with management interests and shareholders. Despite the presence/absence of remuneration disclosure, management may also be doing EM if the company has a high debt to equity ratio. Based on debt covenant hypothesis, management is triggered to choose an accounting policy that can increase profit. Furthermore, according to the political hypothesis, if companies have high political costs, the management will choose accounting policies that reduce earnings. One of the management's objectives of reporting a smaller profit is to avoid the emergence of new rules, such as tax laws. By reporting a smaller profit, the management hopes to avoid a large tax amount. This hypothesis may also be resulting in EM.

One of the reasons of EM is done by the management to avoid risk. Furthermore, EM may be due to management's view that investors prefer stable corporate financial conditions, this is usually done by levelling the earnings that will be reported to the shareholders, in which, the goal is to convince investors and potential investors that the company is in a stable condition. Scott (2015) states income smoothing is the most attractive form of EM. Management does this smoothing profit due to their contract of employment agreement. Managers who are not risk takers do this to maintain their positions. Managers feel that they are dismissed from their positions if the profits they report do not match what the stockholders expect. Especially for the management with a single work contract period, if the manager succeeds in improving performance, then the manager continues to be employed, but if it fails, the employment contract is terminated.

Basically, the conflict of interest between principals and agents always creates problems. The existence of information asymmetry may also lead to accounting fraud. The results of this study indicate that the presence of remuneration within a company has no effect on EM that the management has various motives to do EM.

2.2. The effect of board of commissioners' size on earnings management

Based on the results of hypothesis testing (Table 1), it can be seen that SBC does not have any effect on EM (sig. = 0.653). This result is supported the study conducted by Uzun, Szewczyk, and Varma (2004) in the US in 1978 – 2001 that finds similar findings. Uzun *et al.* (2004) points out that SBC has no effect on the effectiveness of the board's monitoring function to prevent accounting crime in the company. This means that SBC will have no effect on EM.

This result is differing to the study by Rahman and Ali (2006) in Malaysia that show a positive and significant relationship between DA and SBC. González and García-Meca (2014) also find that SBC will create a communication and coordination problem that will decrease monitoring function and increase EM. Their study proves that SBC has a positive effect on EM. However, our results show that there is no effect of SBC on EM that commissioners are coordinating and implementing their duties and responsibilities to increase company performance. The number of commissioners with their own specialties monitors and controls the management behavior that act in their own interests.

SBC has its own limitations or obstacles in performing supervisory functions on the occurrence of EM in a company. In a company, the board of directors is a solid working team. On the one hand, with the growing number of board of commissioners, each member can share their experience, knowledge and expertise to improve the monitoring function that ultimately can compress EM. Commissioner's board will motivate each other to give the best results for the company. But on the other hand, the large SBC will also create communication constraints between them so as to create problems in carrying out supervisory functions. A less effective supervision function will certainly create an opportunity for the practice of EM within a company.

On the other hand, the small SBC will facilitate mutual coordination between the members. Communication systems between commissioner's board will become easier to implement. But a small number can also create other obstacles. With fewer board sizes there will be limited opportunities for sharing expertise and information between the members. As the number of board member increases, the more members of the board can share information, knowledge and expertise, they also can motivate and mutually monitor each other. If the size of the board of directors is small, then this will also be an obstacle in performing supervisory functions in a company. Fixed earnings management can occur under such condition within a company. The effectiveness of the monitoring function performed by the board of directors may also be caused by the presence of directors who have or occupy important positions in other companies. Directors who have multiple positions or hold too many important positions in another company will have difficulty in focusing in supervising one company. As a result, SBC will not have an influence on the internal monitoring system, if in a company; there are members of the board of directors that have dual positions in other companies. The state of a company with a director that holds duplicate positions in another company will break the concentration of the board of directors in performing their duties and responsibilities.

2.3. The effect of frequency meeting of commissioners board on earnings management

FMBC is a GCG mechanism that is expected to monitor management behavior. Our result shows that FMBC does not have any effect on EM (sig. = 0.494). This result also supports the results of Uzun *et al.* (2004), which in his study found that there is no significant effect of FMBC on EM. But these results differ from those of González and García-Meca (2014) suggesting that more meetings indicate greater involvement of the board of directors in tasks and performing monitoring functions and may reduce the occurrence of EM practices. Their research illustrates that the number of board meetings will negatively affect the occurrence of EM practices. González and García-Meca (2014) conduct a study on non-financial companies listed in Latin America in 2006–2009 and uses Jones Modified Model that has been modified by Dechow, Sloan, and Sweeney (1995) to estimate the accrual components of earnings. The difference in company sector of the sample study may causes the differences in the results yield.

Board meetings are where board members share important information. Board meetings are also a place to coordinate with each other. The research results show that the frequency of meetings of the board of directors has no effect on EM because of other factors. One of them is caused by the number of boards of directors attending the meeting. The frequency of many meetings with the attendance of the entire board members will certainly affect EM. The frequency of frequent or regular meetings held without the presence or active participation of the director to attend the meeting will have no effect on EM.

The board of directors has the responsibility for monitoring to ensure the achievement of value creation for shareholders. Regular meeting which is one of the efforts to exchange ideas between boards of directors is one form of monitoring. This routine meeting is expected to keep the company on its original goal of creating value added for stakeholders. The monitoring function will only be effective with the participation of all boards of directors by being present and actively involved in regular meetings. If routine meetings are attended only by a few or even a small number of board members, the expected supervisory function arising from these meetings will not be achieved.

2.4. The effect of frequency of shareholders meeting on earnings management

Based on the result, FMS has a positive effect on EM (sig. = 0.002). This result is in line with the results of Hemraj (2004). Research conducted by Hemraj (2004) aims to observe the role of directors, shareholders and audit committees. Hemraj (2004) explains that the director must monitor the company effectively sustainably, and that shareholders have failed to carry out its monitoring function in the company and cause the audit committee to ensure that the director performs their duties more effectively. The result of Hemraj (2004) concludes that shareholders have failed to conduct supervision and this can lead to EM. Shareholders' meeting is a place to communicate and coordinate among shareholders of the company. These meetings should be utilized effectively so they can be an effective monitoring tool for shareholders. Shareholders general meeting is a place for shareholders to play an active role, communicate with each other so that they can influence the actions and direct the management. For shareholders, in this meeting they can voice their rights and interests. The presence of shareholders in the meeting held will certainly play an important role in monitoring and determining the direction of company policy.

At annual general meetings, shareholders will ensure the achievement of their interests. In the general meeting there will be agency issues between the majority and minority shareholders, especially for the majority shareholders and other highly critical shareholders. They will use the opportunity in this meeting as effectively as possible to be able to ensure that their interests are met. There will be many meeting agendas discussed in annual shareholder meetings that will determine the direction of the company. The result of this shareholder meeting will also affect the management policy in carrying out its responsibilities. According to de Jong, Mertens, and Roosenboom (2006) at the general meeting of shareholders, the matters to be discussed include the adoption of annual accounts requiring shareholder approval, profit sharing, issue of shares plan, stock purchase plan, remuneration, appointment and dismissal members of the board of directors, and much more. Shareholders will mandate the board of directors to monitor the management performance. Good or bad supervision by the board of directors may affect the shareholder vote for remuneration or replacement of board members. This shows the importance of shareholders 'participation in shareholders' general meeting.

In a general meeting, all shareholders will be invited. At the annual general meeting, the shareholders are the parties who will approve the contracts to be made within the company and shareholders will elect a board member. Members of this board of directors will be acting on behalf of the shareholders. Members of the board of directors who are deemed to be able to increase the value of the company will be retained, but the director who is considered unable to increase the value of the company will be replaced. One of the agendas discussed in the shareholder general meeting is a bonus or remuneration for the board of directors. Remuneration is one of the feedbacks on management performance appraisal. The agenda of the general meeting of shareholders will discuss either the amount or form of remuneration that will be given. From the data on the agenda of the general meeting of shareholders listed in the company's annual report shows that from 216 annual reports, there are 124 annual reports revealing remuneration for directors in the agenda of general meeting of shareholders or equal to 57.4% of RD in the remuneration agenda for directors. The shareholders' decision on the remuneration policy will certainly have an effect on the management in determining the policies, including the accounting policies they use. The accounting policies employed result in EM.

2.5. Effect of managerial ownership on earnings management

In a company, if the owner as a management company, then this will be able to reduce conflicts of interest. But according to Htay *et al.* (2012), directors who have substantial shareholdings may not disclose their information to outsiders because they can use their discretionary ability to use resources owned by the company for their personal gain. From this study, the result of fifth hypothesis is MO has no effect on EM. This is apparent from the hypothesis test results p = 0.807. This result is not in line with the results of the Htay *et al.* (2012) study which finds Social and Environmental Information Disclosure negatively related to the ownership of directors which means that EM will have a positive influence on MO.

Ownership of shares in a company shows the power to be able to determine the direction of company policy. The greater the amount of stock ownership in the company, the greater the power it has. The smaller the number of stock ownership, the less power it has to participate in determining company policy. Less dominant shareholders have less dominant power over economic decision making such as investment decisions, financial decisions and other economic decisions. In contrast, minority shareholders have little power to influence decision making. The very small MO is almost non-existent is one of the factors causing no significant effect on EM. The relatively small shareholding of the director shows the director's weakness. In addition, small MO also causes them not to cover transactions in order to gain a share of their ownership. They lack the motivation to undertake or adopt policies that can make bias financial statements presented. As a result, MO has no effect on EM.

2.6. Effect of institutional ownership on earnings management

The last result showed IO has no effect on EM. This is apparent from the results of the hypothesis test p = 0.623. This result is in line with Ujiyantho and Pramuka (2007) research which found that IO has no effect on EM. These results also support the results of Uzun, Szewczyk, and Varma (2004) which also stated that IO has no effect on

EM. This result shows that IO is not effective in monitoring the behavior of management who want to take advantage of the company. IO with large number of shares they have should be able to control the direction of company policy. The higher number of institutional shareholders, the better internal controls was implemented by company. Agency theory explains that parties with large shareholdings can exercise control by using their power. Controls conducted by IO should be able to direct the management. But it turns out IO is not able to control or discipline the management.

The results of this study are in line with Ujiyantho and Pramuka (2007). IO is the owner who focuses more on current earning; consequently, the management may be triggered to take actions that will increase short-term profit, for example by manipulation. The existence of IO leads managers to be tied to meet the profit targets of investors, so managers will still tend to engage in EM. This result is also in accordance with Scott (2015) which mentions one of the hypotheses of positive accounting theory that is Bonus Plan Hypothesis. The measure of success is how much value the agents have created. Agents will make accounting policies under their contract. These policies include choosing operating policies, financial policies, and investment policies. The actions of these managers will affect the outcome of their performance. This final result will then be assessed, and managers will be paid in accordance with existing contracts.

To achieve the desired profit target of institutional investors, management practices EM. The greater income that they report to the institutional stakeholders, the more bonus they will get. As a result, managers choose accounting policies that can increase income or current earnings that will be reported to IO. This has caused IO to have no effect on EM in the company.

Conclusion

This study aims to examine the effect of GCG mechanisms on EM on firms listed on IDX period year 2009–2012. The existing data indicates during 2009–2012 there were 54 companies listed continuously on IDX. From the data obtained 216 company annual report. From the test results can be concluded that the model with independent variables as many as six variables simultaneous have no significant effect on the dependent variable (EM).

The test results also show that partially obtained that of the six independent variables; only one variable (FMS) has influence on EM in manufacturing companies listed on IDX period year 2009–2012. The frequency meeting of shareholders has a significant positive effect on EM. Other variables have no significant influence to EM.

This research has many deficiencies that still require improvement and development in future research. This study only observes manufacturing companies listed on IDX period year 2009–2012. The number of observation years is only four years. There are recent studies that have even used more samples, from different sectors of the company, and are not limited to just one sector. Some recent research on EM has also been using the modified Jones model.

Based on the limitations in this study, the implications for future research that can be submitted are that future research is expected to use more samples of the company or with more years of research. It is intended that the test results can obtain good results.

From this research, there is only one variable of GCG mechanism that has influence to EM that is frequency of shareholder meeting, so in future research is expected to add another GCG mechanism which has influence to EM, for example audit committee (Suprianto *et al.* 2017), proportion of independent commissioners, and others. Thus, it is hoped that the results of the research obtained provide better empirical evidence.

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