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The Role of Independent Commissioner in Moderate Effect of Financial Performance and Compensation on Earnings Management

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Abstract

This study aims to determine the effect of financial performance and compensation on earnings management moderated by independent commissioners. This research was conducted in a manufacturing company listed on the Indonesia Stock Exchange in 2016-2020. The number of samples in this study were 26 companies with the number of observations obtained as many as 130 observations using the purposive sampling method. Data collection uses the documentation method. The data analysis technique used is moderated regression analysis. The results showed that financial performance had a positive effect on earnings management. Compensation has no effect on earnings management. Independent commissioners moderate the effect of financial performance on earnings management. Independent commissioners are unable to moderate the effect of compensation on earnings management. The theoretical implication of this research is to support agency theory and positive accounting theory, while practically this research can make a positive contribution to all parties, especially companies, management and the main users of financial statements.

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1 Introduction

Several factors that can affect earnings management include financial performance and compensation. The financial performance of a company is one of the fundamental aspects of the company's financial condition which can be done based on the company's financial ratio analysis in a period. Financial performance is also one of the benchmarks for external parties to observe the development of the company's performance. Information regarding the company's performance must be conveyed to investors so that profit reporting needs to be presented so that investors continue to assess that the company is in good performance (Scott & Davis, 2015). From several analysis of financial statements, which is often used to assess financial performance is the analysis of financial ratios. According to Ross et al. (2002), financial ratios are calculated relationships and financial information of a company and are used for comparison purposes. Financial performance in this study was measured using profitability ratios. Profitability is the company's ability to generate profits through the operation of its assets. The profitability ratio used is Return on Assets (ROA). The higher the Return on Assets (ROA), the more efficient the use of assets and the greater the profit (Hasty & Herawaty, 2017). Based on this, it can encourage managers to carry out earnings management in order to be able to present their best performance to maintain the trust of creditors and shareholders.

Sulistyanto (2008), compensation plan hypothesis or compensation is one of the various motivations for earnings management by management, management tends to use and choose accounting methods that will increase the company's profit rate. Compensation given by the company to the board of commissioners and directors can be in the form of benefits received directly, goods, and remuneration for services in the form of salaries. The amount of the compensation given depends on the amount of profit achieved in that year, by increasing the profit generated it will increase the amount of compensation that will be received as well. The existence of compensation based on the achievement of profit targets can make the opportunistic nature of management appear to maximize the achievement of compensation by performing earnings management (Sosiawan, 2012). Several cases regarding earnings management have been proven to have resulted in the destruction of the economic, ethical, and moral order. Until now there are still differences in views and understanding of this managerial engineering activity. Earnings management practices are very important to study in the midst of unstable Indonesian economic conditions. Under normal conditions, Indonesia has become a country with the highest earnings management practices in ASEAN countries. It is suspected that earnings management practices are increasing due to these difficult times. Companies are required to keep costs as low as possible while on the other hand the management also wants to get compensation from achieving company profits.

Various phenomena that underlie the practice of earnings management inspire some researchers to conduct a study on earnings management. Dewi & Priyadi (2016), states that profitability has a positive effect on earnings management, while leverage has a negative effect on earnings management. Research by Juzfita & Rahmawati (2020), concludes that liquidity has no significant effect on earnings management, profitability has a significant negative effect on earnings management, activity ratios have no significant effect on earnings management, leverage has a significant negative effect on earnings management. Hasty & Herawaty (2017); Sihombing (2020), research states that profitability has a significant positive effect on earnings management. In the research conducted by Astari & Suputra (2019), it is stated that financial performance has a positive effect on earnings management. In contrast to research Asyati & Farida (2020); Intan et al. (2019), explain that financial performance has no significant effect on earnings management. Research that examines the effect of compensation on earnings management is Panjaitan & Muslih (2019), showing that there is a significant positive effect between compensation on earnings management. In line with the results of research conducted by Arianti & Wijayanto (2019), which examined the effect of compensation on manufacturing companies, they stated that compensation had a positive effect on earnings management. The results of research by Julia (2019); Muyassaroh (2019), also show that compensation affects earnings management practices but in a negative direction. In contrast to research conducted by Florensia & Yuyetta (2017); Tifanny & Rahmawati (2020), shows that compensation has no effect on earnings management.

From several studies related to earnings management, the results are mixed and still inconsistent. This is due to the use of proxies from each of the different research variables. With the inconsistency of the results carried out in previous studies, several variables are conceptually estimated to affect earnings management such as financial performance and compensation. by adding an independent commissioner variable in minimizing earnings management practices, in previous studies this variable did not appear. The independent board of commissioners is effective in supervising the performance of management. According to the KNKG (2006), an independent commissioner is a board of commissioners needed to ensure that the company is free from conflicts of interest, pressure and effect from other parties in every decision making. The number of members of the board of commissioners must be in accordance with

the complexity of the company while taking into account effectiveness in decision making. Membership of independent commissioners comes from outside the company who are the people who are responsible for providing oversight over the performance of management and conveying it to shareholders. Therefore, maximum supervision from the independent board of commissioners will minimize earnings management actions.

The focus of this research is on non-financial services such as manufacturing, which includes the industrial sector, chemical sector, and consumption sector. Data samples were taken from manufacturing companies listed on the Indonesia Stock Exchange. This is because manufacturing companies are ogled by most investors because manufacturing companies are good pilot companies that have complete cost details and from some cases drag manufacturing companies into the pit of earnings management practices. The sample in all sectors of manufacturing companies is devoted to companies that submit the 2016-2020 financial reporting period so that the results of this study are based on the latest financial conditions in the company. Research conducted by Astari & Suputra (2019), states that financial performance has a positive effect on earnings management. Similarly, the results of Sihombing (2020), show that financial performance as measured by return on assets has a positive effect on earnings management. Financial performance in this case is seen through the profitability ratio, namely Return On Assets (ROA) which shows the level of the company's ability to generate profits. The higher the financial performance as measured by ROA, the better the productivity of assets in obtaining net profits. This causes Return On Assets to encourage management to carry out earnings management (McNichols, 2000; Chung et al., 2002).

- H_1: Financial Performance has a positive effect on earnings management.
  The compensation plan hypothesis is one of the motives for choosing an accounting method that cannot be separated from the positive accounting theory. This hypothesis states that managers of companies with compensation plans prefer accounting methods that increase current period earnings. This choice is expected to increase the present value of the compensation that would have been received had the compensation committee of the Board of Directors not adjusted to the chosen method (Watts & Zimmerman, 1990). If the company has a compensation mechanism, the manager will manipulate the company's net income to maximize the compensation that will be received. Supported by research by Arianti & Wijayanto (2019), which examines the effect of compensation on manufacturing companies, states that compensation has a positive effect on earnings management. Research from Panjaitan & Muslih (2019), shows that partially compensation has a significant effect in a positive direction on earnings management.
- H_2: Compensation has a positive effect on earnings management
  In agency theory, there is an agency problem between the principal and the agent. The principal wants a high and fast return on his investment. Principals assess agents based on their ability to manage good earnings performance. When profits are high, the agent is considered successful or has good performance. From here arises the agent's efforts to beautify the financial statements so that the agent's performance looks good. The implementation of a good corporate governance mechanism will also be able to provide good protection to investors, so that companies tend to be transparent to shareholders. In this study, the corporate governance mechanism used is an independent board of commissioners. Independent commissioners are expected to be able to detect wrong decision-making from management, where the independent board of commissioners plays an important role in overseeing management performance. Based on previous studies related to the effect of financial performance on earnings management, there are still inconsistencies in research results, so this study refers to Ghozali (2006); Govindarajan (1986), using contingency variables in the form of moderating variables, namely independent commissioners who are thought to be able to moderate the effect of financial performance. on earnings management (Davis & Albright, 2004; Horváthová, 2010).
- H_3: Independent commissioners moderate the effect of financial performance on earnings management
  In positive accounting theory, the high compensation given by the company to the manager or management of the company will be considered as tangible evidence that the company provides a separate assessment for each key management. Providing compensation in any form will encourage managers to create a good image in the company. Managers will encourage the company's profitability to increase to always meet the target level of compensation provided. So it is possible that here the manager will commit a violation of the accounting method by means of earnings management practices. The board of commissioners is collectively tasked and responsible for supervising and providing advice to the board of directors and ensuring that the company implements good corporate governance (KNKG, 2006). The more the number of members of the board of commissioners, the better the supervision that can be carried out supported by coordination between members of the board of

commissioners in the company. Based on previous studies related to the effect of compensation on earnings management, there are still inconsistencies in research results, so this study refers to Ghozali (2006); Govindarajan (1986), using contingent variables in the form of moderating variables, namely independent commissioners who are thought to be able to moderate the effect of compensation. on earnings management.

- H_4: Independent commissioners moderate the effect of compensation on earnings management.

2 Methods

This research was conducted in manufacturing companies listed on the Indonesia Stock Exchange by accessing the website www.idx.co.id and downloading the annual reports of manufacturing companies for the 2016-2020 period. The dependent variable in this study is earnings management (Y). The moderating variable used in this study is the independent commissioner (M). The dependent variable used in this study is financial performance (X1) and compensation (X2). The calculation of earnings management with discretionary accruals uses the New Approach of Dechow et al. (2012), with the following steps: Develop a formula to calculate discretionary accruals (DA) as follows:

$$DAi,t = a + bPARTi,t + \varepsilon i,t \ldots.1$$

Information:
PART = dummy variable set to 1 in the period in which the hypothesized determinants of earnings management did occur and 0 otherwise.

Proposing the standard assumptions of OLS, the OLS estimator, b denoted by bˆ, is the best unbiased linear estimator with standard error. So the formula is:

$$SE(\hat{b}) = S\varepsilon/[\ (n-1)SPART] \ldots\ldots2$$

Information:
n = Number of observations
Sε = Standard error of regression
bˆ = earnings management quantity
SPARE = standard deviation over sample PART

Because discretionary accruals are very difficult to observe directly, a proxy for discretionary accruals (DAP) is formulated, which is a discretionary accrual that takes into account the element of error. So the formula becomes as follows:

$$DAPit = (DAit - \mu it) + \eta it \ldots.3$$

Information:
μ = discretionary accruals accidentally deleted from DAP
η = non-discretionary accruals that are inadvertently still attached to DAP

To analyze the specification error, then DAP is substituted for DA in the following equation:

$$DAPit = a + bPARTit + (-\mu it + \eta it + \varepsilon it) \ldots 4$$

Information:
Furthermore, the OLS estimator b obtained from regressing DAP to PART is denoted by b, which is a specification error due to regression error (-μ + η). Specifically b is a bias estimator of b, which can be determined by the following formula:

$$E(b\ ) - b = \beta(-\mu + \eta)PART \ldots.5$$

Information:
(-μ + η)PART = is the regression coefficient of the regression result (-μ +) to PART.

Calculating the standard error b with the following formula:

$$SE(b) = SE(\hat{b})(1-r^2(-\mu + \eta)(PART)) / ((1-r2(DAP)(-\mu + \eta)(PART))...6$$

Information:
r2 (-μ + η)(PART) = r squared regression result (-μ + η) to PART.
r2(DAP)(-μ +)(PART)) = r squared of DAP regression results to the component (-μ + η) which is orthogonal to PART.

Independent commissioners can be calculated by the following formula:

Board Size = Number of Members of the Board of Commissioners
Independent Commissioners = Number of Independent Commissioners/Number of Members of the Board of Commissioners……7

In this study financial performance with profitability indicators, in measuring this ratio can use the following formula:

ROA= (Net profit after tax)/(Total Assets)….8

The formula used in measuring compensation is as follows:

Compensation = Ln Compensation….9

The population in this study are all manufacturing companies listed on the Indonesia Stock Exchange (IDX) in 2016-2020. The sample used is a manufacturing company listed on the Indonesia Stock Exchange (IDX) in 2016-2020 which is in accordance with the sample selection criteria in this study. The analytical technique used in this research is moderated regression analysis (MRA).

3 Results and Discussions

This study uses moderated regression analysis (MRA) to determine the effect of financial performance and compensation on earnings management moderated by independent commissioners. Completely and clearly the results of the moderated regression analysis are presented in Table 1.

Table 1
Moderated regression analysis test results

Model		Unstandardized Coefficients B	Std. Error	Standardized Coefficients Beta	T	Sig.
1	(Constant)	-1,503	0,546		-2,755	0,007
	Financial Performance	0,528	0,118	1,013	4,473	0,000
	Compensation	0,075	0,143	0,112	0,525	0,600
	Independent commissioner	0,851	1,397	0,215	0,609	0,544
	Financial Performance* Independent commissioner	-0,704	0,248	-0,972	-2,842	0,005

Compensation* Independent commissioner	0,382	0,349	0,636	1,094	0,276

Source: Secondary data, 2021

The results of the analysis in this study indicate that financial performance (X1) has a positive effect on earnings management. Based on the results of the regression test, the financial performance variable has a regression coefficient of 0,528 with a significance value of 0,000 < 0,05 so it can be concluded that the financial performance variable has a positive effect on earnings management. Thus, the first hypothesis which states that financial performance has a positive effect on earnings management is accepted. Financial performance shows the results of the company's achievements and success which can be interpreted as the results that have been achieved on various activities that have been carried out. The higher the financial performance as measured by ROA, the better the productivity of assets in obtaining net profits. This shows that the higher the results of the company's financial performance seen from its profitability, the higher the earnings management action. This research is in line with the research of Dewi & Priyadi (2016); Hasty & Herawaty (2017); Astari & Suputra (2019); Sihombing (2020), which state that profitability used as an indicator of financial performance in this study has a positive effect on earnings management.

The results of the analysis show that compensation (X2) has no effect on earnings management. Based on the results of the regression test, the compensation variable has a regression coefficient of 0,075 with a significance value of 0,600 > 0,05 so it can be concluded that the compensation variable has no effect on earnings management. Thus the second hypothesis which states that compensation has a positive effect on earnings management is rejected. The amount of compensation is not the main motivation for management to carry out earnings management (Sosiawan, 2012). Opportunistic actions that may be taken by the management to practice earnings management, are not commensurate with the risks to be borne. The provision of other compensation that is greater in value than compensation such as facilities and allowances also supports managers to continue to act as they are or in reporting the company's financial statements. This result is in accordance with the results of research by Florensia & Yuyetta (2017); Tifanny & Rahmawati (2020), who found that compensation has no effect on earnings management. This shows that the high or low compensation provided by the company will not indicate the existence of earnings management practices (Murphy, 1999; Armstrong-Hélouvry et al., 1994).

Based on the results of the regression test, the moderating variable of financial performance (X1) and the independent commissioner (M) has a regression coefficient of -0,704 with a significance value of 0,005 < 0,05 so it can be concluded that the independent commissioner moderated the effect of the financial performance variable on earning management. Thus, the third hypothesis which states that independent commissioners moderate the effect of financial performance on earnings management is accepted. The size and composition of the board determines the effectiveness of corporate governance mechanisms so as to reduce earnings management actions. On average, manufacturing companies have fairly good independent commissioners, namely 42% have complied with POJK regulations No.33/POJK.04/2014 concerning the percentage of independent commissioners of at least 30% of the total members. Larger board structures make coordination, communication and decision-making more practical, so they are more powerful than smaller board structures (Smith, 2010; Tornberg et al., 2002).

The significant effect shows that the supervisory function by the independent commissioner is optimal. The existence of independent commissioners is proven to be able to control management so that managers cannot take actions that benefit themselves. The results of this study support the research of Jensen & Meckling (1976), which states that external supervision (Independent Commissioner) is expected to reduce agency conflicts between principals and agents related to earnings management. In solving agency problems, the presence of external supervisors (Independent commissioners) is very necessary, the more the number of supervisors, the lower the possibility of conflict between owners and managers (Jensen & Meckling, 1976). Based on the results of the regression test, the moderating variable of compensation (X2) and the independent commissioner (M) has a regression coefficient of 0,382 with a significance value of 0,276 > 0,05 so it can be concluded that the independent commissioner variable is not able to moderate the effect of the compensation variable on earnings management. Thus, the fourth hypothesis which states that independent commissioners moderate the effect of compensation on earnings management is rejected. In research data, the average value of compensation is greater than the standard deviation, indicating that the company has provided large compensation to managers so that it supports managers to continue to act as they are or in reporting the company's financial statements (Almeida & Cunha, 2017; Nordlöf et al., 2015). In line with the weak significance of independent commissioners, the effect of compensation is also not significant on earnings management because the high or low

compensation provided is not a guarantee that the manager's opportunistic actions will increase, so compensation is not a factor that indicates the practice of earnings management.

Table 2
Coefficient of determination test results (Adj. R^2)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	0,842[a]	0,709	0,697	0,27216	1,897

Source: Secondary data, 2021

Based on Table 2 shows the coefficient of determination in this study seen from the value of Adjusted R Square obtained by 0,697. This indicates that 69,7% of earnings management variables are explained by financial performance variables, compensation, independent commissioners, interaction of financial performance with independent commissioners and compensation interactions with independent commissioners, while the remaining 30,3% is explained by other variables that are not incorporated into the research model.

Table 3
F Test Results

ANOVA[a]						
	Model	Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	22,385	5,000	4,477	60,442	0,000[b]
	Residual	9,185	124,000	0,074		
	Total	31,569	129,000			

Source: Secondary data, 2021

Based on the test results shown in Table 3, the results of the model feasibility test show that the p-value (Sig. F) of 0,000 is less than 0,05. This shows that the model used in this study is fit (Soni & Chandak, 2017; Dewi & Wirama, 2019).

4 Conclusion

The results of this study provide additional empirical evidence that is expected to be a concern for investors in analyzing companies and making investment policies. As illustrated in agency theory, a conflict of interest will cause managers to not optimally act as agents who manage the company according to the interests of the owner. Based on the research results, it is important for investors or shareholders to pay attention to the management of the company by management. Practically, the results of this study have implications for the effectiveness of the monitoring function of independent commissioners in manufacturing companies listed on the Indonesia Stock Exchange. Independent commissioners are one of the mechanisms of good corporate governance (GCG) designed to reduce conflicts between shareholders and management. With the supervisory function through the proper implementation of corporate governance, it is hoped that the achievement of the company's performance will be optimal.

To increase the confidence of shareholders in the company, the company must be able to show good performance and convey relevant and reliable information to interested parties, especially investors regarding the company's development, without having to do profit engineering. Investors in investing in the capital market should pay attention to the company's performance and the quality of reported earnings to reduce the occurrence of errors in investing in the capital market. Earnings management actions carried out both with the aim of efficiency and opportunistic will reduce the quality of the earnings presented. Investors are expected to make investment decisions not only based on the earnings information disclosed by the company but should also pay attention to the company's fundamental information. Earnings management actions can have both positive and negative impacts. Earnings management actions have a positive impact if earnings management indicates a better condition of the company. On the other hand, earnings management actions have a negative impact if the information provided does not fully reflect the state of the company

and obscures the value of the company, causing other parties to make wrong decisions. Further researchers who want to conduct similar research, compensation variables can use other measurements such as dummy. Measurement of financial performance can use other financial ratios such as liquidity, solvency and activity ratios. As for moderating, you can use several variables of the internal corporate governance mechanism or you can add several variables related to the external corporate governance mechanism so as to produce better research results.

Conflict of interest statement
The authors declared that's they have no competing interests.

Statement of authorship
The authors have a responsibility for the conception and design of the study. The authors have approved the final article.

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