THE INFLUENCE OF CORPORATE GOVERNANCE MECHANISM ON EARNINGS MANAGEMENT

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ABSTRACT

This research aims to study the relationship between corporate governance mechanism and earnings management. Corporate governance, proxied by institutional ownership and managerial ownership are the mechanism that is expected to reduce this practice by minimizing the agency problem. Earnings management is proxied by absolute discretionary accruals. Control variables are used in this research are company size, Return on Assets and Leverage.

The number of samples used in this research is 70 manufacturing companies which are listed in Indonesia Stock Exchange during three consecutive years 2014-2016, therefore the number of sample companies used during three years is 210. These companies are selected by using purposive sampling technique. The analysis method used in this research is multiple linear regression analysis. The conclusions based on the results indicate that institutional ownership and managerial ownership have negative not significant influence on earnings management, control variables company size has negative significant influence on earnings management, return on assets has positive significant influence on earnings management, and leverage has positive not significant influence on earnings management.

Keywords: *Earnings Management, Corporate Governance Mechanism, Company Size, Financial Performance*

BACKGROUND

The information needed for making decisions include accounting information. A number of accounting information users consider reported income as a “sufficient statistic” for the performance of a company or as accountable information as the basis for making decisions (Ziv, 1998). The situation where the shareholders or investors expect positive information influences the management’s behavior in disclosing information. The information provided to investors are made up by the management not to completely representing the actual performance of the company. According to Widyastuti (2009), the management will conduct a variety of methods so the company’s performance appear positively which attracts investors to buy the stocks traded by the company. The condition that the information is only accessible by certain individuals while the others have no access on such information is known as information asymmetry (Deegan, 2014). Asymmetry between management (agent) and owners (principal) opens the opportunity for managers to conduct an earnings management (Ziv, 1998).

Sun (2016) states that earnings management occurs when managers perform discretion over financial reporting to achieve various objectives and consequently economic decisions that are based made on financial information will affect resource allocation throughout the economy. Earnings management is the intervention of the management to manipulate company’s earnings by using the accounting methods and/or procedures (Soenamo, 2016). Nasution and Setiawan (2007) stated that one of the causes of earning management is the lack of good corporate governance. The corporate governance system provides effective protection for shareholders and creditors so they are confident of receiving the right amount of return on their investment (Nasution and Setiawan, 2007). In Indonesia, evidence suggests that weak corporate governance practices in lead to deficiencies in corporate decision making and corporate action (Alijoyo et al., 2004) in Ujiyantho and Pramuka (2007). According to agency theory, to handle and overcome the conflict of interest between principal and agent is through the practice of good corporate governance (Boediono, 2005). Corporate governance is one key element to increase economic efficiency, which include a series of relationships between company management, board of committee, shareholders, and other stakeholders. Corporate governance also establishes a structure which facilitiates the objectives-setting of a company, as well as a means to determine performance monitoring techniques.

Corporate governance mechanism in relation to earnings management that will be studied in this research are managerial ownership and institutional ownership. Incentives to involve in earnings management practice could be reduced through the implementation of effective corporate governance mechanisms such as ownership structure (Yang et al., 2009). Earnings management practice as a result of conflict of interests can be minimized through a monitoring mechanism that aims to align various interests. First, is by increasing the ownership of the company's shares by management (Jensen and Meckling, 1976 in Ujiyantho and Pramuka, 2007). As a consequence, the interests of the owner or shareholder will be aligned with the interests of the manager. Second, is the share-ownership by institutional investors. Boediono (2005) suggested that institutional investors are parties who can monitor agents with large holdings, therefore the managers' motivation to manage earnings is reduced. The idea was supported by Ujiyantho and Pramuka (2007), conducted that managerial ownership had negative significant influence to earnings management. Sriwedari (2012) suggested that good corporate governance had the ability to produce financial statements which contain earnings information and that both managerial and institutional ownership had negative effects on earnings management.

Sun (2016) argued that in the diversity of accounting choices and practices, accounting harmonization −which is a way to establish a common language in accounting profession− should eliminate the behavior of earnings management regardless of the motivations of the individuals practicing it. Indonesia has come to the gradual convergence to International Financial Reporting Standards since 2012. A research by Cornier (2013) concluded that accounting convergence has modified the role of corporate governance on information asymmetry. In Indonesia, the standards has been adopted since 2012 and began to gradually converge since then. Soenamo (2016) did a research on how the adoption of the standards could impact the earnings management practice in Indonesia. Based on the study in Indonesian manufacturing companies in the period 2009-2014, the researcher found that there are differences in the average of discretionary accruals in before and after 2012.

Prior researches have shown several contradicting results of the effect of corporate governance mechanism, company size and financial performance on earnings management. Widyastuti (2009), Sriwedari (2012), and Aygun et al. (2014) found that institutional ownership had significant effect in reducing earnings management practice whereas Yang et al. (2009) and Agustia (2013) found that institutional ownership had no significant effect on earnings management. Even, transient institutional shareholders may pressure the company to inflate its earnings (Ronen and Yaari, 2008). Widyastuti (2009) and Sriwedari (2012) concluded that managerial ownership had significant negative effect to earnings management, on the contrary Aygun et al. (2014) found that managerial ownership had significant positive effect on earnings management because managers that own a large amount of shares ownership are likely to perform earnings management in order to maximize their personal benefits. Aryani (2011) and Yuliana and Trisnawati (2015) found that company's size had positive significant influence in earnings management while Grecco (2013) found that company's size had negative significant influence in earnings management. Widyastuti (2009), Aryani (2011), Hadidi and Sutrisno (2017) company's leverage had significant positive influence on earnings management Grecco (2013), Aygun et al. (2014), Dewi (2016) leverage had significant negative influence on earnings management. Aryani (2011), Aygun et al. (2014), Yuliana and Trisnawati (2015) found that ROA had significant positive influence on earnings management while Dewi (2016) and Hadidi and Sutrisno (2017) found that ROA had no significant effect on earnings management.

Aside from the factor that accounting convergence has created changes in earnings management practice in Indonesia (Soenamo, 2016), this research will discuss about how corporate governance in terms of ownership concentration, company size, and financial performance (leveage and return on assets) impact the earnings management practices in Indonesia as there are a few contradicting results from the prior studies mentioned. This research will examine the relationship of the following two variables independent; institutional ownership and managerial ownership, and three control variables; company size, leverage, and return on assets to earnings management which is proxied by company's absolute discretionary accruals in Indonesia Stock Exchange listed manufacturing companies during year 2014 to 2016.

LITERATURE STUDY

Agency Theory

According to agency theory (Eisenhardt, 1989), there is an agency problem within a corporation that occurs when cooperating parties achieve to different goals and labor division (Jensen and Meckling, 1976; Ross, 1973). Agency theory points at the omnipresent agency relationship, where one party (the principal) assigns work to another (the agent), the party who conducts that work. Agency theory describes this kind of relationship using the term "a contract" in Jensen and Meckling (1976) as cited by Eisenhardt (1989).

The principal and agent are likely to have conflicting goals and there are governance mechanisms that confine the agent's self-serving behavior. According to the basic human characteristic assumption, a manager as human possesses opportunistic behavior which accentuates his self-interests (Deegan, 2014).

According to Ali (2002) in Ujiyantho and Pramuka (2007), the occurence of earnings management can be explained by agency theory. As an agent, manager is morally responsible of optimizing the principal's benefit and will be receiving compensantion as stated in contract in retun. Therefore, there are two different interests within a company which each party strives to reach its own desired level of fortune. The managers tend to report certain things that will maximize their utilities.

. Information asymmetry occurs when managers have better knowledge on internal information and company's prospect in the future compared to other shareholders and stakeholders. Managers could provide signal regarding the company's condition to the investor to maximize the value of company's shares. The signal is given through disclosure of accounting information (Tyasari, 2009).

Earnings Management

Earnings management is a process that is conducted intentionally by management of a corporation in creating accounting decisions that alters the corporation's bottom lines as well as modify the standards of Generally Accepted Accounting Principles (GAAP). Earnings management is a practice that has a direct effect on the entire integrity and quality of financial reports. According to Sun (2013), earnings management emerges when managers have the authority over financial reporting to meet various objectives and as a consequence economic decisions that are made following those financial information will influence the allocation of resource along the economy. Earnings management is very likely to imply low accounting quality as modified information in financial statement is not able to reflect the firm's real main economic performance and therefore has an adverse effect on resource allocation. Earnings management can be a form of increasing or decreasing the current reported earnings. Ziv (1998) also defined earnings management as a time manipulation (or other) earnings profile, while not making changes for the reported earnings in the long run. Based on various definitions by a number of researchers, Diri (2017) defines earnings management as the management discretion within GAAP that is practiced over external financial reporting by violating several contracting deficiencies, bounded rationalities of the stakeholders, as well as information asymmetry occurs in the market through several economic decisions, an alteration in accounting treatment, or such other methods.

Corporate Governance

The importance of corporate governance arises in nowadays corporations as a result of the separation of management and ownership control in the organizations. The interests of shareholders are conflicting with the interests of managers. The principal-agent problem is resembled in the management and direction related problems as there are different interests of firm's stakeholders. The understanding of company's ownership is very important because it is related with the control of company's operational activities. From perspective of accounting theory, earnings management is high determined by the motivation of company's manager (Boediono, 2005). The five fundamental principles of implementing good corporate governance as published in Indonesia's National Committee of Governance Policies (KNKG, 2006) are as follows: transparency, accountability, responsibility, independency, and fairness.

Mechanisms are the way things work systematically to fulfill some requirements. The mechanism of corporate governance is a clear procedure and relationship between decision-making parties and those who exercise control of the decisions. According The World Bank (2000), the frameworks in corporate governance are divided into internal and external architecture.

The challenge is that, the key governance mechanism is the shareholders need to appoint the directors that can act on shareholder's behalf by controlling the performance of the managers (The World Bank, 2000).

The external mechanisms such as laws and regulations that create discipline to the organizations' insiders are meant to strengthen those internal mechanisms. The external mechanism includes the legal requirements that needs to be complied by the company and this minimizes agency problems through transparency, compliance, and monitoring by regulatory bodies (The World Bank, 2000).

Literature Review

There are several researches in the related field have been conducted previously. Table 1 shows the summary of prior researchers including the variables being studied as well as the result. These researches are the primary references in conducting this study.

Table 1 List of Prior Researches

No.	Researcher(s)	Year	Variables	Methodology	Research Result
1	Muh. Arief Ujiyantho and Bambang Agus Pramuka "Mekanisme Corporate Governance, Manajemen Laba Dan Kinerja Keuangan"	2007	Dependent: Discretionary Accruals (DA), Cash Flow Return on Assets (CFROA) Independent: Institutional Ownership, Managerial Ownership, Board Independent Commissioner, Board Commisisioner Size	Multiple Regression Analysis	Institutional ownership had no significant influence to earnings management; managerial ownership had negative significant influence to earnings management; independent of director had positive significant influence to earnings management; size of director had no significant influence to earnings management; earnings management had no significant influence to financial performance.

2	Wong Shi Yang, Loo Sin Chun And Shamsher Mohamad Ramadili "The Effect of Board Structure and Institutional Ownership Structure on Earnings Management"	2009	Dependent: Discretionary Accruals (DA) Independent: Institutional ownership, Managerial ownership Control: Leverage, Firm size, ROA	Multiple Regression Analysis	Institutional and managerial ownership structures had negative not significant influence on earnings management; company size, leverage, and profitability had significant positive influence on earnings management.
3	Tri Widyastuti "Pengaruh Struktur Kepemilikan Dan Kinerja Keuangan Terhadap Manajemen Laba: Studi Pada Perusahaan Manufaktur Di BEI"	2009	Dependent: Discretionary Accruals (DA) Independent: Leverage, Firm size, Institutional ownership, Managerial ownership, ROA	Multiple Regression Analysis	Institutional and managerial ownership structures had negative significant influence on earnings management; company size, leverage, and profitability had significant positive influence on earnings management.
4	Dwi Septa Aryani "Manajemen Laba Pada Perusahaan Manufaktur Di Bursa Efek Indonesia"	2011	Dependent: DA Independent: ROA, Leverage, Size	Multiple Regression Analysis	ROA, leverage, size had positive significant influence on earnings management.
5	Tuti Sriwedari "Mekanisme Good Corporate Governance, Manajemen Laba Dan Kinerja Keuangan Perusahaan Manufaktur Di Bursa Efek Indonesia"	2012	Dependent: Discretionary Accruals (DA) Cash Flow Return on Assets (CFROA) Independent: Institutional ownership, Managerial ownership, Independent board commissioner, Audit committee	Multiple Regression Analysis	Institutional and managerial ownership had negative not significant effect on earnings management; proportion of independent board commissioner and audit committee had positive not significant influence to earnings management, earnings management had negative not significant influence on financial performance.
6	Dian Agustia "Pengaruh Faktor Good Corporate Governance, Free Cash Flow, dan Leverage Terhadap Manajemen Laba"	2013	Dependent: Discretionary Accruals (DA) Independent: Audit committee size, Proportion of independent board commissioners, Institutional ownership, Managerial ownership, Free Cash Flow, Leverage ratio Control: Firm size	Multiple regression analysis	Audit committee size, proportion of independent board commissioners, institutional ownership, and managerial ownership had no significant influence on earnings management. Leverage and free cash flow had significant negative impact on earnings management.

7	Mehmet Aygun, Suleyman Ic & Mustafa Sayim "The Effects of Corporate Ownership Structure and Board Size on Earnings Management: Evidence from Turkey"	2014	Dependent: DA Independent: Institutional ownership, Managerial ownership, Board Size Control: ROA, Leverage, Firm Size	Multiple regression analysis	Institutional ownership, board size, and leverage significantly negatively affect earnings management. Managerial ownership and ROA significantly positively affect earnings management.
8	Yulistia Hati Hadidi and Paulina Sutrisno "Pengaruh Motivasi, Struktur Kepemilikan, Kualitas Audit Terhadap Manajemen Laba"	2017	Dependent: absDA, AbnCFO Independent: Leverage, Political cost motivation (Firm size), Auditor quality, Bonus motivation (ROA), Managerial Ownership, Institutional Ownership	Multiple regression analysis	Lev, size, and audit quality had positive effect on accrual earnings management. ROA and audit quality had positive effect on real earnings management.

Source: Multiple sources, processed by the author, 2017

Hypotheses Development

Institutional Ownership and Earnings Management

According to Jensen and Meckling (1976), the owner of a firm can limit discrepancies from his interest by incurring monitoring costs in order to limit the aberrant conducts, of the agent. Institutional ownership has the ability to control the management through an effective monitoring process to reduce the practice of earnings manipulation. The percentage of shares owned by the institution is likely to affect the process of financial statements preparation which does not set aside any accrualization in the interest of the management (Boediono, 2005). Widyastuti (2009) and Sriwedari (2012) found evidences that indicate that the controlling activities conducted by a company and insitutional investor party can limit the manager's abberant behavior. Aygun et al. (2014) found that there was a negative significant influence between institutional ownership on earnings management. This indicates that institutional perceptions will reduce inappropriate utilization of accounting policies in accrual activities. Corporate monitoring actions by an institutional investor will drive the managers to focus their attention on the company's performance so as to reduce opportunistic or self-serving behavior.

However, Yang et al. (2009) and Agustia (2013) found that institutional ownership had no significant influence on earnings management. According to (Ronen and Yaari, 2008), the role of institutional shareholders in affecting earnings management is based on their investment horizon. If they act as transient institutional shareholders, they will not complain to earnings management practice if they sell their shares at inflated price or purchase shares at deflated price. Transient institutional shareholders even may pressure the company to inflate its earnings because they are pressured to purchase stronger shares and sell weaker shares to appear that they have high returns, or known as "window dressing" scheme. Therefore, institutional investors' impact towards earnings management practice is based on whether they act as transient owners or as a gatekeeper.

H1: Institutional ownership negatively influences earnings management.

Managerial Ownership and Earnings Management

Earnings management practice often initiated by the interest of the company's managers. Agency theory explains that the principal and the agent possess different motivations respectively. This leads managers to manage company's earnings to fulfill their motivation such as bonus and incentives that are given based off of company's performance. Different motivations will result in the different value of earnings management, such as between managers who are also shareholders and managers who are not (Ujiyantho and Pramuka, 2007).

Managerial ownership, when the managers own a number of shares in the company, will have the ability to minimize the conflict of interest and the different motivation between the principal and the managers. Managers act as the principal (owner) therefore they will behave as to the interest of shareholders. When managers have the ownership, they will attempt to ensure that the financial statements are presented unqualified and reflect the true conditions. Warfield et al., (1995) in (Ujiyantho and Pramuka, 2007) found a negative relationship between managerial ownership and discretionary accruals as a measure of managerial ownership and positive relationship between managerial ownership and earnings information content.

Aygun et al. (2014) found a contradicting result that managerial ownership has positive effect on earnings management. Managers that own a large amount of shares ownership are likely to perform earnings management in order to maximize their personal benefits (Cheng and Warfield, 2005 in Aygun et al., 2014). Furthermore, the managers might also only act as plain investors and their market incentives to manipulate earnings increase when acknowledging a relationship between reported income and the market value of the company (Yang et al., 2008).

H2: Managerial ownership negatively influences earnings management.

RESEARCH METHODOLOGY

Population is all components or members from the objects that are being observed. Population of this research is all manufacturing companies that are listed in Indonesia Stock Exchange (IDX) on 2014-2016. Samples for this research are taken from Indonesian manufacturing companies by using purposive sampling technique. The sampling is confined to specific characteristics of the source which could provide the desired information. Data is obtained from Indonesia Stock Exchange (IDX) with the following criteria:

1) The manufacturing companies that are listed in Indonesia Stock Exchange during the year 2014 to 2016
2) The companies consistently publish financial statements during the year 2014 to 2016
3) The companies provide financial statements in the currency of Indonesian Rupiah (IDR)
4) The companies have positive income before extraordinary items during the period 2014 to 2016

Operational Variable Definitions

Table 2 Operational Variable Definitions

Variable	Definition	Scale	Formula
Absolute Discretionary Accruals	Discretionary expenses recorded in the book and are to be realized	Residual value (absolute)	$(TAC_t / A_{t-1}) = \alpha_1(1/ A_{t-1}) + \alpha_2((\Delta REV_t - \Delta REC_t) / A_{t-1}) + \alpha_3(PPE_t / A_{t-1}) + e$
Institutional Ownership	The number of shares of the company owned by institutions	Ratio	-

Managerial Ownership	The number of shares of the company owned by management	Ratio	-
Company Size	The size of the company in terms of its amount of assets	Natural logarithm	Ln(Total Assets)
Leverage	The company's financing that is obtained from debts	Ratio	$\frac{\text{Total Liabilities}}{\text{Total Assets}}$
Return on Assets (ROA)	The return of the utilization of assets	Ratio	$\frac{\text{Net Income}}{\text{Total Assets}}$

Source: Multiple sources, processed by the author, 2017

Research Samples Description

According to the sample selection criteria using the purposive sampling method, as explained in Chapter III, this research uses 70 manufacturing companies during three years from year 2014-2016. The total research observations are 210 companies. There are three sectors in manufacturing industry; which are basic industry and chemicals, miscellaneous industry, and consumer goods industry. The sample selection description is shown at table 3 below.

Table 3 Sample Selection Description

Description	Amount
The number of manufacturing companies that are listed in Indonesian Stock Exchange during 2014-2016	**144**
The number of companies that are not consistent in publishing complete financial reports during 2014-2016	**(10)**
The number of companies provide financial statements in non Rupiah currency	**(28)**
The number of companies with negative income before extraordinary items during 2014-2016	**(36)**
The number of companies used in research sample	**70**
Total sample companies used in the research	**210**

Descriptive Statistics Analysis

Descriptive statistics are used to describe the data in statistics. For descriptive statistics with dependent variable ABSDA, is presented in table 4.

Table 4 Descriptive Statistics

Variable	Mean	Std. Dev.	Min.	Max.
ABSDA	0.0682518	0.0826692	0.0000592	0.509927
INST	0.647796	0.2477679	0	0.9942
MNGR	0.0337515	0.0759231	0	0.3732
SIZE	14.58248	1.582317	11.80397	19.37619
LEV	0.4021495	0.1788289	0.0696761	0.8637721
ROA	0.0927796	0.0878258	0.0004211	0.4270126
ABSDA is discretionary accruals which is measured by The Modified Jones Model (1995), using the absolute value. INST is institutional ownership that is calculated by the amount of shares held by institutions divided by the company's total amount of shares. MNGR is managerial ownership that is calculated by the amount of shares held by the				

management divided by the company's total amount of shares.
LEV is leverage that is calculated by total liabilities divided by total assets of company i on year t.
SIZE is company size that is calculated by natural logarithm total assets of company i in year t.
ROA is return on assets that is calculated by net income divided by total assets of company i in year t.

Source: STATA OUTPUT, processed secondary data, 2017

Normality Test

Normality test is used to indicate whether the data are distributed normally in terms of statistic. Normality test is conducted with Shapiro-Wilk normality test. The value of probability z is 0.00000 less than 5% which means that the data is not distributed normally, however the number of observation is 210 (210≥200). The amount of sample sizes of 200 or exceeding, it has the effect to lessen the detrimental effects of nonnormality condition (Hair, Jr. et al, 2010). When the size of the sample is sufficiently large which exceeds 200, the normality assumption is not necessary at all because the Central Limit Theorem makes sure regarding the matter that the distribution of term of disturbance will approximate normality (SS, 2013).

Multicollinearity Test

Multicollinearity test is aimed to test in the regression model whether there is an occurence of high or perfect correlation among independent variables (Ghozali, 2011). A good regression model should not contain correlation among the independent variables. Table 5) shows VIF mean value less than 10. This indicates that there is no multicollinearity problem.

Table 5 Collinearity Statistics

Variable	Collinearity Statistics	
	VIF	Tolerance (1/VIF)
INST	1.46	0.683108
MNGR	1.49	0.670250
SIZE	1.31	0.763639
LEV	1.22	0.820488
ROA	1.18	0.845211
Mean VIF	1.33	

Source: STATA OUTPUT, processed secondary data, 2017

Heteroskedasticity Test

Heteroskedasticity test is aimed to test whether in the regression model there is not equal variance of residuals. Heteroskedasticity test is performed by using Breusch-Pagan/Cook-Weisber test for heteroskedasticity. Test result indicates the value of prob Chi Square ABSDA 0.0000 less than 5%. This figure indicates that variable ABSDA contains heteroskedasticity problem.

As there is a heteroskedasticity problem, therefore a treatment is conducted to overcome the occurence of heteroskedasticity problem by using linear regression with robust HC3.

Multiple Regression Analysis Result

This analysis is used to test the effect of independent variables (INST, MNGR, SIZE, LEV, ROA) to the dependent variable discretionary accruals (ABSDA). The following is the value of constant and regression coefficients for multiple regression equation that is used in this research.

Table 6 Multiple Regression Linear Analysis Test

Model	Coefficient	Robust HC3 Std. Err.
(Constant)	0.2179733	0.0894232
INST	-0.0227175	0.0351656
MNGR	-0.0247083	0.0652038
SIZE	-0.0133073	0.0051157
LEV	0.0711198	0.0544364
ROA	0.3371562	0.1514016

Source: STATA OUTPUT, processed secondary data, 2017

Multiple regression model used in this research in an equation obtained from the table 6 multiple regression analysis test is as follows.

ABSDA= 0.218 - 0.023INST - 0.025MNGR - 0.013SIZE + 0.071LEV + 0.337ROA

Description:

ABSDA: discretionary accruals (absolute DA)

INST : institutional ownership

MNGR : managerial ownership

SIZE : company size

LEV : company's leverage ratio

ROA : company's return on assets (ROA)

Hypothesis Testing

Simultaneous Significance Test (F-Statistic Test)

The F-Statistic test is used to indicate whether all the independent variables used in the regression model simultaneously affect the dependent variable as shown in the F-value. Based on result of simultaneous test (F-test) indicates that the value of F-value is 2.39 with the probability of 0.0393. The probability of 0.0393 is lower than significance value of 0.05 indicates that the simultaneous relationship between the dependent and independent variables is significant at 5% or α = 0.05. This result indicates that the model fits with the data and is proper for further examination. This suggests that institutional ownership, managerial ownership, company size, leverage, and return on assets have influence on earnings management.

Coefficient of Determination Test

Empirical model has adjusted R^2 ABSDA of 0.1094 indicates that dependent variable earnings management which is proxied by ABSDA (absolute discretionary accruals) can be explained by independent variables institutional ownership, managerial ownership, company size, leverage, and ROA (return on assets) by 10.94% while the remaining 89.06% is explained by other variables that are not analyzed in this research model.

t-Statistic Test Results

t-Test is conducted to determine whether the hypotheses is rejected or accepted by looking at the probability of t-value whether it is significant at 1%, 5%, or 10% (α = 0.01, α = 0.05, or α = 0.1).

Table 7 t-Test Result

Variable	Coefficient	Robust HC3 Std. Error	t-Statistic	Sig.
Constant	0.2179733	0.0894232	2.44	0.016
INST	-0.0227175	0.0351656	-0.65	0.519
MNGR	-0.0247083	0.0652038	-0.38	0.705
SIZE	-0.0133073	0.0051157	-2.60	0.010
LEV	0.0711198	0.0544364	1.31	0.193
ROA	0.3371562	0.1514016	2.23	0.027

Source: STATA OUTPUT, processed secondary data, 2017

Hypothesis 1 in this research proposes that institutional ownership has negative influence on earnings management practice. The regression result shown in table 7 indicates that institutional ownership (INST) has a negative coefficient of -0.0227175 and t-value of -0.65 with the probability of 0.519 > 0.1. This figure indicates that institutional ownership (INST) is negatively not significant at 1%, 5%, and 10% level (α = 0.01, α = 0.05, and α = 0.1). Therefore, Hypothesis 1 is rejected.

Hypothesis 2 in this research proposes that managerial ownership has negative influence on earnings management practice. The regression result shown in the table 7 indicates that managerial ownership (MNGR) has a negative coefficient of -0.0247083 and t-value of -0.38 with the probability of 0.705 > 0.1. This figure indicates that managerial ownership (MNGR) is negatively not significant at 1%, 5%, and 10% level (α = 0.01, α = 0.05, and α = 0.1). Therefore, Hypothesis 2 is rejected.

DISCUSSION

Institutional Ownership and Earnings Management

Based on t test, t statistic is -0.65 and probability 0.519 which is not significant at α = 0.01, α = 0.05, and α = 0.1 indicates that INST has negative not significant influence towards earnings management practice. This finding is consistent with the research conducted by Yang et al. (2009) and Agustia (2013). The result indicates that institutional ownership has no significant capability in monitoring the conduct of the management therefore it cannot reduce the earnings management practice. According to this result, institutions may not be able to fully position as the monitoring party to constrict the managers in managing earnings. Institutional investors have no sufficient financial sophistication in detecting manipulation of earnings and become a passive monitoring group (Yang et al., 2009). Institutional investors do not take role as sophisticated investors that have greater ability in disciplining the managers in order to focus on the company's value and restrain earnings management practice, however, they perform the role as current owners that focus more on current earnings (Agustia, 2013). According to Ronen and Yaari (2008), the role of institutional shareholders in affecting earnings management is based on their investment horizon. If they act as transient institutional shareholders, they will not complain to earnings management if they sell their shares at inflated price or purchase shares at deflated price. Long-term institutional owners also do not lose due to the price decline given the allegation of earnings management, even if the decline in the price is substantial, as long as they do not sell their shares ownership. This finding is in contrast to research by Aygun et al. (2014) which indicates that institutional ownership has negative significant relationship with earnings management.

Managerial Ownership and Earnings Management

Based on t test, t statistic is -0.38 and probability 0.705 which is not significant at α = 0.01, α = 0.05, and α = 0.1 indicates that MNGR has negative not significant influence towards earnings management practice. This finding is inconsistent with Widyastuti (2009) that managerial ownership has significant negative influence on earnings management, also inconsistent with Aygun et al. (2014) concluded that managerial ownership has positive significant influence to earnings management. This result is consistent with the research by Sriwedari (2012) that managerial ownership mechanism has negative not significant relationship with earnings management practice. This means that managerial ownership does not give any significant contribution in controlling or reducing the earnings management practice. According to Stulz (1998) in Aygun et al. (2014), the higher level of ownership by management is seen as one of the important incentives that motivate to the managers to ensure the correct preparations of financial statements. However, on average, the managerial ownership proportion during the period of this observation is relatively small which is around 3 percent compared to the entire shares owned by other investors. This means that the proportion of managerial ownership does not dominate the company's ownership. This may cause the managers may not have full control on minimizing earnings management practice because they tend to serve the interests of investors, as investors are willing to invest in the company while looking at the managed reported earnings. The outcome of earnings management can lead to the rise in share price which this benefits the investors. When the managers have no complete or major ownership of the company, there will appear the indication of agency problem (Ehrhardt and Brigham, 2011). This may explain that the managers that hold share ownership do not completely act as owners because their ownership is not as significant. On the other hand, they may not be fully able to reduce earnings management attempt that aims to make the company's performance appear good in front of major shareholders or investors.

CONCLUSION

This research aims to study and obtain empirical evidence regarding the mechanism of corporate governance, company size and financial performance in influencing earnings management practice. This research uses 70 manufacturing companies that are listed in Indonesia's Stock Exchange (IDX) during three years (2014-2016) or 210 sample companies.

According to analysis result and discussion that has been conducted by multiple linear regression in this research, then it is concluded that the model is fit with the data and worth to be further analyzed, which is with level of significance $\alpha = 0.05$. The research results show that company size significantly negatively influence earnings management and return on assets (ROA) significantly positively influence earnings management. Institutional ownership, managerial ownership, and leverage do not significantly influence earnings management practice.

The research result is consistent with the research by Agustia (2013), found that institutional ownership and managerial ownership had no significant negative influence in earnings management practice. Institutional investors do not take the role of monitoring. Institutional investors focus more on current earnings which this makes the managers manage earnings to achieve their desired targets. The proportion of managerial ownership is relatively small compared to the shares owned by other investors. When the managers do not own major proportion of the company, there occurs agency problem which the managers act to serve their personal interests. Size has significant negative influence to earnings management, this result is inconsistent with Widyastuti (2009) and Yuliana and Trisnawati (2015). The larger the size of the company, the more public scrutiny that the company receives. This might be the reason the larger companies have less tendency in performing earnings management as it could harm their reputation. Leverage has no significant effect to earnings management. This result is consistent with a research by Ardison et al. (2012). This might be because the debtholders act as monitoring parties to the companies that obtain the debts, thus this makes the managers have the constraint to manage the earnings as they are being monitored. ROA has positive significant influence to earnings management, this result is consistent with Aryani (2011) and Dewi (2016). This indicates that the managers manage the earnings because they are tied with the bonus policy which is determined by the company's financial performance.

Research Limitation

According to analysis result and discussion that has been conducted, these are the limitations in this research as follows:

1. This research only uses absolute discretionary accruals The Modified Jones Model (1995) as dependent variable.
2. This research uses sample of 70 manufacturing companies of manufacturing companies that are listed in Indonesia Stock Exchange (IDX) during 2014-2016 and uses the period of three years.

Suggestions for Future Researches

This research result provides a few suggestions for future researches, which are:

1. The future researches are suggested to use the period of more than 3 years.
2. The future researches are suggested to use other dependent variable other than discretionary accruals of The Modified Jones Model (1995), such as The Business Model developed by Ye (2006) which answers to the deficiencies in the Jones model.
3. This research uses manufacturing companies as samples. Future researches are suggested to use other types of companies as research samples.

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