ECONOMICS FACULTY
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THESIS

THE INFLUENCE OF BOARD OF COMMISSIONERS' CHARACTERISTICS ON EARNING MANAGEMENT;

The Case of Manufacturing Company Listed in IDX

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ABSTRACT

The objective of this study to examine the influence of Board of Commissioners' characteristics, which are Board of Commissioners' size, Board of Commissioners' composition and Independent Commissioners' experience in finance on earning management. This study takes sample from 42 companies listed in the manufacturing sector at Indonesian Stock Exchange (IDX) from 2004-2006. To avoid bias, company's size functioned as controlling variable. The results of this study show that Board of Commissioners' size has insignificant positive influence on earning management. In the case of Board of Commissioners' composition, it has negative significant influence on earning management before adding the controlling variable. Nevertheless, after adding the controlling variable into the regression model, Board of Commissioners' composition has insignificant negative influence on earning management. Independent Commissioners' Experience in finance also has insignificant negative influence on earning management. The results of this study have revealed that monitoring function by Board of Commissioners is not running well in Indonesian manufacturing company.

Keyword: Board of Commissioners' characteristics, earning management.

CHAPTER I

INTRODUCTION

1.1 Background

Earning management by companies has been popular in academic literature since years ago. Although earning management cannot be interpreted as a negative action since it does not solely concern with earning manipulation (Gumanti 2000), the recent facts have revealed in separate way. While Enron and WorldCom are the prime examples of earning management practice, in the year of 1998 to 2001, financial scandals, which involved Indonesian Public Company such as PT Lippo Tbk and PT Kimia Farma by manipulating their financial statement, has been proven (Boediono 2005). These facts have generated a public perception that earning management is utilized opportunistically by company's managers for their own interest rather than for company it self. Financial statement as a management's major tool in informing company's financial condition has changed to be a source in abusing information in order to achieve certain purpose. This action has injurious some parties concerned, especially shareholders.

Discussing earning management cannot be separated from agency concept. In agency concept, principals (shareholders) give mandate to agents (managers) to perform some service and delegating decision-making authority to agents. Managers, as company's executive know more about internal information and company's future prospect than the shareholders do. Because of that, managers have to distribute signal about company's condition to principals. This signal could be the accounting information such as financial statement that makes shareholders relied on financial statement much more. This unbalance condition aims to information asymmetry (Ujiyantho 2006). However, the information that distributed sometimes is not the real one. This unreal information could distributed because the information asymmetry between managers and external information users allows managers to use their discretion in preparing and reporting information for their own advantage.

In financial statement, which is the representation of accounting information, exists earning as an important component that used as performance measurement. Hence, earning often been manage by managers to "make up" their performance. Earning management its self would create unreliable information to users, especially the external users (investors, creditors, and government). This action has blurred the real company's performance and decreased shareholder's ability in decision-making.

Being investigated this issues, it makes sense to observe from corporate governance overview. Hart (1995 in Ningsi 2006) suggests that corporate governance issues arise in organization whenever two conditions are present. First, there is an agency problem, or conflict of interest, involving members of organization - these might be owners, managers, workers, or consumers. Second, transaction costs are such that this agency problem cannot be dealt with through a contract.

The main reason for management tendency in manage the earning management is the lack of corporate governance practices. Corporate governance defined as a set of rules, which determine the relationship between shareholder,

CHAPTER V

CONCLUSION

5.1 Conclusion

The purpose of this research is to observe the corporate mechanism influences, which is Board of Commissioners' characteristics on earning management. Board of Commissioners' characteristics including Board of Commissioners' size (BoCSize), Board of Commissioners' composition (BoCComp), and Independent Commissioners' experience in finance (IbCExp). This research uses Indonesian manufacturing listed company as population and chose 42 sample in period 2004 – 2006. Size of company will be functioned as variable control to avoid bias in analyzing data. The results of hypothesis testing are:

1. Hypothesis 1: Board of Commissioner's size has significant positive influence on earning management.

   From the hypothesis testing, the significant value of Board of Commissioners' size in alpha level (α) 0.05 is 0.468 > 0.05 (α) and coefficient value is 0.021.

   Conclusion: first hypothesis (H1) rejected, which Board of Commissioner's size has insignificant positive influence on earning management.

2. Hypothesis 2: Board of Commissioners' composition has significant negative influence on earning management.

   From the hypothesis testing, the significant value of Board of Commissioners' composition (BoCComp) in alpha level is 0.011 < 0.05 (α) and coefficient value is -0.008.

   Conclusion: second hypothesis (H2) accepted, which Board of

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