The Effect of Financial Distress and Leverage on Earnings Management with Good Corporate Governance as a Moderation Variable

Waode Rizky Amalia[1], Yohanis Rura[2], Abdul Hamid Habbe[3]

123Faculty of Economics and Business, Hasanuddin University Makassar, Indonesia

ABSTRACT: Earning management is an option for companies experiencing financial distress and having a high degree of leverage. This study aims to examine the effect of financial distress and leverage on earnings management with good corporate governance as a moderating variable. The approach used to test the hypothesis in this study is a quantitative approach. The object of this research is manufacturing companies listed on the Indonesia Stock Exchange for the 2017-2019 period. Data obtained by using purposive sampling, namely as many as 62 companies that meet the criteria for sampling with secondary data as a source of data in the form of company annual reports. Data were analyzed using multiple linear regression methods and Moderated Regression Analysis methods with the IBM SPSS Statistics 23 application as analysis tools. The results showed that financial distress affects earnings management. Leverage affects earnings management. Good corporate governance moderates financial distress on earnings management, but good corporate governance does not moderate leverage on earnings management. Information regarding earnings management can be used as a reference in making investment decisions and policies so that they can produce an optimal investment.

KEYWORDS: Financial Distress, Leverage, Earnings Management, Good Corporate Governance.

Received 29 Mar, 2021; Revised: 10 Apr, 2021; Accepted 12 Apr, 2021 © The author(s) 2021.
Published with open access at www.questjournals.org

I. INTRODUCTION

Financial reports are a means of communicating financial information to parties outside the corporation. One of the important components of financial statements is profit. Profit is an important factor for investors so that it is often used as a target for engineering company management to maximize profits, which on the other hand, of course, can be detrimental to shareholders or investors. This earnings engineering behavior is known as earnings management.

Puri and Gayatri (2018) state that earnings management is a management action in the process of compiling financial reports so that it can increase or decrease accounting profit according to interests. One of the factors in the emergence of earnings management practices is financial distress. The economic crisis experienced by the company continuously will cause the company to experience financial difficulties. Platt (2009) states that financial distress is a condition that a company is experiencing financial distortion and pressure which will gradually lead to bankruptcy. When there is financial difficulty, it is expected that the company can take action to anticipate these conditions. In general, actions that can be taken by the company can be in the form of shutting down operations, factories, or divisions, reducing production, postponing certain projects, not paying dividends, or reducing the number of employees. However, companies can also anticipate financial difficulties by implementing earnings management practices so that they are expected to save the company from these conditions. Based on agency theory, the principal authorizes the agent to make the best decisions for the principal. Earnings management is a management effort to satisfy shareholders by reducing company risk. Companies experiencing financial difficulties tend to practice earnings management to always provide good signals in the eyes of investors. Puri and Gayatri (2018) state that earnings management behavior increases along with the increasing condition of financial difficulties experienced by the company.

There are several studies on financial distress, including research by Puri and Gayatri (2018) which found that financial distress affects earnings management. The results of this study are in line with Chairunesia et al. (2018) who also found that financial distress has a positive and significant effect on earnings management. Unlike the case with the research of Ghazali et al. (2015) who found that company managers will practice
earnings management when the company is not in financial distress and will do the opposite if the company is in trouble. This study is consistent with Platt (2009) who explains that the main reason why distressed firms are not involved in earnings management is simply that they have exhausted their tools for performing earnings management and managing earnings before financial difficulties occur and they may fail to feel the benefits. of the earnings management.

Another factor that has an important relationship with earnings management and can help stakeholders identify earnings management is leverage. According to Harjito and Martono (2011), leverage is a ratio that measures how much a company uses funds from debt (loans). The greater the leverage ratio, it means that the higher the value of the company's debt, the greater the risk faced so that the owner will ask for a higher profit level so that the company is not threatened with liquidation.

Every party who has an interest in and has a contract with the company uses accounting variables in the financial statements to monitor the progress of the contract with the company. Creditors as lenders of funds to companies also base their accounting information by asking for financial ratios to be maintained, including leverage. Companies with high leverage ratios will experience difficulties in obtaining additional funds from creditors, even if the company is threatened with violating the debt agreement. Thus, in companies that have high leverage ratios, company managers tend to carry out earnings management. In the positive accounting theory formulated by Watts and Zimmerman (1986), three hypotheses encourage the emergence of the earnings management phenomenon, namely the bonus plan hypothesis, the debt covenant hypothesis, the political cost hypothesis. Earnings management arises because of an agency conflict. According to the debt covenant motivation, earnings management that is carried out is not solely based on the utility itself but is based on the company's interests, namely maintaining the company's reputation in the view of external parties. Because if the company does not carry out earnings management, the company will get a bad image that can even affect stock performance, or even affect the continuation of the company itself.

Research by Pradito and Rahayu (2015) found that leverage has a positive effect on earnings management. This result is in line with Wijaya and Christiawan (2014) who show that companies will try to avoid default by making policies that increase revenue and profit. Unlike the case with Yudiastuti's (2018) research, it shows that leverage has no effect on earnings management. This result is in line with Widianingrum and Sunarto (2018) who found that leverage has no effect on earnings management.

The scandal of fraudulent presentation of financial statements that occurred in several large companies in the world has attracted public attention to the importance of implementing good corporate governance. Naftalia and Marsono (2013) reveal that the corporate governance mechanism is a concept proposed to improve company performance through monitoring management performance and ensuring management accountability to shareholders based on a regulatory framework. Bistrova and Lace (2012) found that companies that have good governance will minimize the manipulation of financial statements. Good corporate governance is expected to reduce earnings management practices and create a clean and healthy business world. There are five important components in corporate governance according to the National Committee on Governance (2006), namely transparency, accountability, responsibility, independence, and fairness. If these five elements are applied, it will continuously improve the quality of financial reports and create a healthy business world. Good corporate governance mechanisms can be seen from institutional ownership, the independent board of commissioners, and the audit committee.

Rice's (2013) research shows that good corporate governance is able to moderate the occurrence of earnings management practices. This is in line with the research of Lestari and Wirawati (2016). Meanwhile, Puri and Gayatri's research (2018) shows that good corporate governance, which is proxied by the independent board of commissioners and the audit committee, is unable to weaken the effect of financial distress on earnings management. Furthermore, research by Dewi and Wirawati (2019) found that good corporate governance is able to moderate the effect of leverage on earnings management. Meanwhile, Savitri and Priantinah (2019) show that good corporate governance, which is proxied by an independent board of commissioners, institutional ownership, and auditor quality, cannot moderate the effect of leverage on earnings management.

The majority of studies in ASEAN, especially Indonesia, use discretionary accruals as a proxy for measuring earnings management, especially the modified Jones model developed by DeChow et al. (1995). There have been many criticisms that have emerged about the strength of the test and the possibility of specifying the modified Jones model, but due to the lack of alternative models that differ significantly, this method is still the most widely used.

Various approaches to measuring earnings management have not changed significantly in the last three decades until finally DeChow et al. (2011) proposed a new approach to identifying accrual-based earnings management. The new approach of DeChow et al. (2011) analyzed the earnings management test, which resulted in (i) testing with a new approach model that is quite appropriate to use in a random sample; (ii) the combined inversion increases the test power by more than 40%; (iii) incorporating accrual reversals in the period after alleged overstatements substantially increase the power of tests for earnings management; (iv) tests that
incorporate accrual reversal is very strong in reducing misspecification on various economic characteristics. Overall, the new approach to detecting earnings management resulted in substantial improvements in test strength and specifications.

II. STATEMENTS OF THE PROBLEM

Based on the above background, the following problems can be formulated.
1. Does financial distress affect earnings management?
2. Does leverage affect earnings management?
3. Can good corporate governance moderate the effect of financial distress on earnings management?
4. Can good corporate governance moderate the effect of leverage on earnings management?

III. LITERATURE REVIEW

A. Positive Accounting Theory

Positive Accounting Theory (TAP) assumes that managers are rational (like investors) and if possible will choose accounting policies that suit their own interests. TAP does not assume that managers will act to maximize the company's profit, but managers will only maximize profit if it is considered by their interests.

Watts and Zimmerman (1986) also put forward three hypotheses related to the opportunistic behavior of management, namely: 1. The Bonus Plan Hypothesis, managers in companies with bonus plans tend to choose accounting policies that move profits from future periods to the current period; 2. The Debt Covenant Hypothesis, when companies approach the limit of debt covenant violations, company managers tend to choose accounting policies that move profits in the future period to the current period; 3. The Political Cost Hypothesis, the greater the political costs faced by the company, the greater the tendency for managers to choose accounting policies that delay current reported earnings to the future.

B. Agency Theory

Agency theory places more emphasis on determining efficient contract arrangements in the relationship between the principal and agent. Jensen (1986) states that the existence of a contract between the principal (owner) and agent (manager) creates responsibility between the two parties. The agent has a moral responsibility to maximize the principal's profits.

The control rights possessed by the manager as an agent are very possible to be manipulated. Separate ownership and control in a company are some of the factors that trigger a conflict of interest called an agency conflict. Agency conflicts arise between parties who have different interests and goals so that it can complicate and hinder the company from achieving positive performance to generate value for the company and shareholders.

Agency theory assumes that the agent and the principal have different information about the condition of the company. This happens because the principal may not continue to oversee every action taken by the agent. This condition is called information asymmetry, where the agent knows more information about the company than the principal. The information asymmetry between the agent and the principal provides an opportunity for the agent to carry out earnings management. Therefore, agents often perform management when reporting the condition of the company to the principal.

Agency theory also assumes that each individual is solely motivated by their own interests, which creates a conflict of interest. Pradito and Rahayu (2015) state that the conflict of interest between the agent and the principal occurs because the agent does not always act according to the principal's interests, so this triggers agency costs. This difference in interest is the reason for management's earnings management practices. An agent performs management to get the desired compensation.

C. Contingency Theory

According to Sutrisno (2013), a system that is applied and is effective in an organization will not necessarily be successful and effective if it is applied to other organizations with different organizational characteristics because it is caused by contingent factors. Contingency theory was first introduced by Lawrence and Lorsch (1967) and then used by Kast and Rosenzweig (1973) which stated that there is no best way to achieve a match between organizational and environmental factors to get good performance for an organization.

This study, using the contingency variable of good corporate governance to see its effect on the relationship between financial distress and leverage and earnings management. Good corporate governance can be defined as the structures, systems, and processes used by company organs to provide added value to the company in a sustainable manner in the long term. Good corporate governance was triggered by the economic crisis that hit the world. To prevent the crisis from recurring, a better company management system and structure were developed. The implementation of good corporate governance requires a company to implement a certain structure and system. About structure, companies are required to create certain organizational
The Effect of Financial Distress and Leverage on Earnings Management with Good Corporate Governance

instruments (such as independent boards of commissioners, audit committees, institutional ownership) to carry out specific functions, whereas, in terms of systems, company management is required to follow certain processes or rules in decision making and in carrying out its activities in general.

D. Earnings Management

Scott (2015) defines earnings management as "management intervention in the process of compiling external financial reporting so that it can increase or decrease accounting profit according to its interests."

According to Scott (2015), there are several patterns of earnings management, namely: taking a bath, income minimization, income maximization, income smoothing. According to Rankin et al. (2012), 2 main motivations encourage managers to carry out earnings management. The first motivation is to benefit the company, namely to meet the expectations of investors and analysts; maximize share price and company value; convey private information accurately, as well as to avoid breaching debt covenants. The second motivation is to maximize the compensation received by managers. According to agency theory, CEOs have different interests from shareholders. Compensation contracts are used to solve the difference in interest. In general, the compensation given to managers is in the form of 4 types, namely basic salary, cash bonus, shares or stock options, and prizes outside of salary such as transportation facilities. Most of the compensation is usually given if the company's performance reaches a certain level. One of the performance measurements is the amount of profit to determine the amount of bonus that will be received. Apart from these motivations, several other incentives encourage managers to carry out earnings management. According to Scott (2015), several other incentives in carrying out earnings management are to reduce political costs, to get subsidies from the government, and to avoid demands from labor unions.

E. Financial Distress

Financial distress is a condition in which a company is experiencing a decline in its financial condition which is usually temporary, but it could develop into a worse condition and end up going bankrupt if the condition is not resolved quickly. There are many types of financial difficulties depending on the categories and causes, here are types of financial difficulties according to Hery (2016), namely: economic failure, business failure, technical insolvency, insolvency in bankruptcy, and legal bankruptcy.

Factors causing financial difficulties, namely starting from the inability to fulfill its obligations, especially short-term liabilities, including liquidity obligations and also obligations in the solvency category. The problem of insolvency can arise from liquidity difficulties. This inability can be demonstrated by two methods, namely stock-based insolvency and flow-based insolvency. Stock-based insolvency is a condition that indicates a condition of negative equity on the company's balance sheet (negative net worth), while flow-based insolvency is indicated by conditions of cash flow (operating cash flow) that cannot meet the company's current liabilities.

F. Leverage

A company makes financial statements as information in making decisions and is used as a measurement of company performance. Through financial ratio analysis, we can understand an overview of a company's ability to meet its obligations to pay debts promptly. Leverage is the use of debt by a company to carry out its operational activities or in investing to provide an overview of the company's condition to shareholders.

Kasmir (2014) states that by analyzing the leverage ratio, the company will know several things related to the use of its own capital and loan capital as well as knowing the ratio of the company's ability to meet its obligations. Once known, the financial manager can take the policies deemed necessary to balance the use of capital. Finally, with this ratio, management's performance so far will be seen whether it is in line with the company's goals or not.

G. Good Corporate Governance

Corporate governance provides guidelines on how to control and direct the company so that it can meet the goals and objectives that add value to the company and can benefit all stakeholders in the long term. Stakeholders, in this case, all parties, from the board of directors, management, shareholders, employees, and the community.

According to the National Committee on Governance (2006), the principles of corporate governance are divided into five, namely: Transparency, Accountability, Responsibility, Independence, Fairness, and Equality.

According to Man and Wong (2013), the good corporate governance mechanism is classified into two as follows.
1. Internal mechanism. Internal mechanisms are influenced by internal company factors which include insider share ownership, board structure and characteristics, the proportion of independent board of directors, director background, audit committee, remuneration committee, and company ownership structure, institutional ownership, managerial ownership, independent audit committee, and independent board of commissioners.

2. External mechanisms. External mechanisms are determined by factors outside the company that aims to regulate companies in support of stakeholder interests, including laws on legal protection and takeover rules.

IV. HYPOTHESIS FRAMEWORK

![Conceptual Framework]

H1: Financial distress has a positive effect on earnings management.
H2: Leverage has a positive effect on earnings management.
H3: Good Corporate Governance can moderate the effect of financial distress on earnings management.
H4: Good Corporate Governance can moderate the effect of leverage on earnings management.

V. RESEARCH METHOD

A. Population and Sample
The population in this study are companies listed on the Indonesia Stock Exchange. The sample used in this study is a manufacturing company listed on the Indonesia Stock Exchange. The technique used in determining the sample of this study is purposive sampling. After the selection of manufacturing companies listed on the Indonesia Stock Exchange during the research period with the above criteria, the research sample was obtained as many as 62 companies, so that the number of observational data was 186 data. The 62 companies are shown in the table below.

B. Types and Sources of Data
The type of data used in this research is documentary data. The data source used in this research is secondary data. Secondary data used were sourced from the publication of the sample manufacturing companies' annual reports which were obtained and accessed through the official website of the Indonesia Stock Exchange (www.idx.co.id).

C. Variable Measurement

1. Financial Distress (X1)
Financial distress is a condition in which the company is facing financial difficulties, namely the company's operating cash flow is unable to pay off current liabilities (trade payables or interest expenses) and the company is forced to take corrective actions to avoid the threat of bankruptcy/liquidation.

In this study, financial distress was measured using the Z Score Altman model (1983) (Shahwan, 2015) (Shahwan, 2015). The Z-Score can be defined as follows:

\[
Z\text{- Score} = 0.717X1 + 0.847X2 + 3.107X3 + 0.42X4 + 0.998X5
\]

Information

\( Z = Z\text{- Score Index} \)
\( X1 = \text{Working Capital / Total Assets} \)
\( X2 = \text{Retained Earnings / Total Assets} \)
\( X3 = \text{Earnings before Interest and Taxes / Total Assets} \)
\( X4 = \text{Market Value Equity / Book Value of Total Debt} \)
\( X5 = \text{Sales / Total Assets}. \)
Based on the Z-score equation above, the Z value is obtained as follows.

a. If the value of Z > 2.90 then it can be categorized in a healthy financial condition.
b. If the value of 1.23 < Z ≤ 2.90, it can be categorized as a company in a vulnerable or unstable condition.
c. If the Z value is ≤ 1.23, it can be categorized as a company in financial difficulty or bankruptcy.

2. **Leverage (X2)**

Leverage is the use of debt by a company to carry out company operations or in investing to provide an overview of the company's condition to shareholders. Leverage in this study is measured by the debt to equity ratio by Kasmir (2014) as follows.

\[
\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Total Equity}}
\]

3. **Earnings Management (Y)**

Earnings management is an action taken by managers by managing accounting data or information so that the amount of profit recorded in the financial statements is by the wishes of the manager, both for personal and corporate interests.

Measurement of earnings management in this study uses a proxy of discretionary accruals which is calculated using the New Model approach by Dechow et al. (2011). Dechow et al. (2011) developed a new formula for measuring earnings management with the following steps.

\[
WA_{\text{ACCit}} = a + bPART_{\text{it}} + cPART_{\text{it}} + \sum k\chi \text{k.i.t} + e_{\text{it}}
\]

Information

\( \chi_k \) = controller for non-discretionary accruals.

4. **Good Corporate Governance (Z)**

Good corporate governance is a concept proposed to improve company performance through monitoring management performance and ensuring management accountability to shareholders based on a regulatory framework. The Good Corporate Governance Index in this study is seen from institutional ownership, the independent board of commissioners, and the audit committee. The measurement for each index is written with the number “1” if there is institutional ownership or an independent board of commissioners or audit committee in the company, and the number “0” if there is no institutional ownership or independent board of commissioners or audit committee in the company. Shahwan (2015) formulates the total corporate governance index score for each company as follows.

\[
CGI_j = \frac{\sum_{i=1}^{n} X_{ij}}{\sum_{i=1}^{n} M_i}
\]

Information

\( M_i \): the maximum possible score for the company for all categories.
\( X_{ij} \): actual score achieved by each company.

### VI. HYPOTHESIS TEST ANALYSIS

**A. Hypothesis Testing Model 1**

To determine the effect of financial distress and leverage on earnings management, multiple regressions are used. Based on the processed data, the following analysis results are obtained.

1. **Determination Test (R2)**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.380</td>
<td>0.145</td>
<td>0.133</td>
<td>2.90696</td>
</tr>
</tbody>
</table>

Source: SPSS Results, 2020

Based on the model summary table above, the amount of R Square shows a value of 0.145 or about 14.5%. This means that the earning management variable is influenced by 14.5% by the financial distress and leverage mechanisms, while the remaining 85.5%. This shows that financial distress and leverage are quite weak in explaining the variation on earnings management because the value obtained is below 50%, while the rest is explained by other variables outside the independent variables studied in this study.

2. **T-test (partially)**

Partial test or also called t-test in multiple linear regression analysis aims to determine whether the independent variable partially (each variable) affects the dependent variable. If the value is sig. <0.05, there is a significant
The Effect of Financial Distress and Leverage on Earnings Management with Good... 

influence between the independent variables on the dependent variable. However, if sig. > 0.05, there is no significant difference between the independent variables and the dependent variable.

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>2.679</td>
<td>0.523</td>
<td>5.118</td>
</tr>
<tr>
<td>Financial Distress</td>
<td>0.271</td>
<td>0.127</td>
<td>0.174</td>
<td>2.138</td>
</tr>
<tr>
<td>Leverage</td>
<td>1.099</td>
<td>0.224</td>
<td>0.397</td>
<td>4.894</td>
</tr>
</tbody>
</table>

Source: SPSS Results, 2020

Based on the table above, the following linear regression equation is produced.

\[ Y = 2.679 + 0.271X1 + 1.099X2 + e \] ........................ (1)

From the above equation it can be explained as follows.

a. The regression constant value is 2.679, which means that if the financial stress ratio and leverage value = 0 or do not change from the initial state, then the earnings management ratio will increase by 2.679. With the use of multiple regression equations in conducting hypothesis testing, the results obtained are the result of a mathematical calculation of 2.679. The results of the multiple regression test can only be applied with the assumption that the financial distress and leverage ratios are fixed or do not change.

b. The regression coefficient X1 for the financial stress variable is 0.271, which means that the effect of financial distress ratios is in line with the increase in earnings management ratios. This shows that financial distress influences the earnings management ratio.

c. The regression coefficient X2 for the leverage variable is 1.099, meaning that the effect of the leverage ratio is in line with the increase in earnings management ratios. This shows that leverage influences earnings management ratios.

Also, to test the hypothesis on the effect of the independent variable on the dependent variable, a t-test test was carried out as follows.

a) The effect of financial distress on earnings management
Based on the table above, the financial distress variable obtained an at-count value of 2.138 with a significance of 0.034 <0.05. Thus, it can be concluded that financial distress has a significant effect on earnings management.

b) The effect of leverage on earnings management
Based on the table above, the t-count value of the leverage variable is 4.894 with a significance of 0.000 because the significance of t is smaller than 5% (0.000 <0.05), it can be concluded that the leverage variable has a significant effect on earning management.

B. Hypothesis Testing Model 2
To determine the moderating effect of the implementation of good corporate governance (GCG) on the effect of financial distress and leverage on earnings management, Moderated Regression Analysis (MRA) is used. Based on the processed data, the following analysis results are obtained.

1. R2 statistical test

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.459*</td>
<td>0.211</td>
<td>0.183</td>
<td>2.82219</td>
</tr>
</tbody>
</table>

Source: SPSS Results, 2020

Based on the table above, the results of the R Square coefficient of determination on the model show a value of 0.211 or 21%. This means that the variable good corporate governance as a moderating variable for the relationship between independent variables on earnings management is influenced by 21%. While the remaining 79% is influenced by other variables outside of this study.

*Corresponding Author: Waode Rizky Amalia
The Effect of Financial Distress and Leverage on Earnings Management with Good Corporate Governance

2. T-test (partially)

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>5.306</td>
<td>0.545</td>
<td>9.741</td>
<td>0.000</td>
</tr>
<tr>
<td>Financial Distress</td>
<td>0.559</td>
<td>0.286</td>
<td>1.956</td>
<td>0.052</td>
</tr>
<tr>
<td>Leverage</td>
<td>1.399</td>
<td>0.297</td>
<td>4.707</td>
<td>0.000</td>
</tr>
<tr>
<td>Good Corporate Governance</td>
<td>-1.557</td>
<td>0.540</td>
<td>-2.881</td>
<td>0.005</td>
</tr>
<tr>
<td>Financial Distress*Good</td>
<td>-0.823</td>
<td>0.398</td>
<td>-2.070</td>
<td>0.040</td>
</tr>
<tr>
<td>Corporate Governance</td>
<td>-0.040</td>
<td>0.360</td>
<td>-0.111</td>
<td>0.911</td>
</tr>
</tbody>
</table>

Source: SPSS Results, 2020

Based on table 5.12 above, the linear regression equation is obtained as follows.

\[ Y = 5.306 - 0.823X_1Z - 0.04X_2Z + e \] ........................ (2)

The above equation can be explained as follows.

a. The constant is 5.306, which states that if the financial stress, leverage, and good corporate governance variables are zero, then the earnings management movement of manufacturing companies listed on the Indonesia Stock Exchange will increase by 5.306.

b. The variable financial distress * good corporate governance provides a coefficient value of -0.823 with a significance value of 0.040 which is smaller than alpha 0.05. Based on the results obtained, partially that the variable good corporate governance is a moderating variable that can weaken the relationship between financial distress and earnings management and is stated as quasi moderation. The variable good corporate governance can be placed as an independent variable as well as a moderating variable.

c. The leverage variable * good corporate governance provides a coefficient value of 0.04 with a significance value of 0.911 greater than alpha 0.05. Based on the results obtained, partially that the good corporate governance variable is not a moderating variable between leverage on earnings management and is expressed as a variable moderation predictor.

Also, to test the hypothesis of the moderating variable the effect of the independent variable on the dependent variable, the t-test was carried out as follows.

a) Good Corporate Governance moderates the effect of financial distress on earnings management

Based on the Coefficients table above, financial distress is moderated by good corporate governance with a count of -2.070 with a significance of 0.04. Thus, it can be concluded that good corporate governance moderates the effect of financial distress on earnings management.

b) Good Corporate Governance moderates the effect of leverage on earnings management

Based on the Coefficients table above, leverage is not moderated by good corporate governance with a count of -0.111 with a significance of 0.911. Thus it can be concluded that good corporate governance does not moderate the effect of leverage on earnings management.

VII. DISCUSSION

A. Effect of Financial Distress on Earnings Management

Testing the financial distress variable produces a significance level of 0.034 and a regression coefficient value of 0.271. The results showed that partially financial distress has a significant positive effect on earnings management. This means that the higher the financial distress experienced by the company will lead to the practice of earnings management. Ware (2015) states that financial distress is a condition where a company is experiencing irregularities and financial pressure which will gradually lead to bankruptcy. When there is financial difficulty, it is expected that the company can take action to anticipate these conditions. In general, actions that can be taken by the company can be in the form of shutting down operations, factories, or divisions, reducing production, postponing certain projects, not paying dividends, or reducing the number of employees. However, companies can also anticipate financial difficulties by implementing earnings management practices so that they are expected to save the company from these conditions. Thus, it can be concluded that financial distress affects earnings management, which means that hypothesis one is accepted.

The results of this study are by the agency theory which explains the principal-agent problem in the separation of ownership and control in a company. Based on the agency relationship, the principal authorizes the agent to make the best decisions for the principal. Earnings management is a management effort to satisfy shareholders by reducing company risk. Healy and Wahlen (1999) explain that earnings management arises when managers use certain decisions to change financial statements so that it will mislead stakeholders who
want to find out the economic performance obtained by the company or to influence the results of contracts by using reported accounting figures. Wang and William (1994) state that earnings management is precisely an action that managers should take. Several studies provide evidence indicating that smoothed earnings are also preferred by the market because firms with flat serial earnings are considered to have a lower risk. This means that not all earnings management motivations are opportunistic, in fact, more earnings management motivations are realistic where the motivation is based on the desire to carry out the company's operations in a sustainable manner (going concerned).

The results of this study are in line with Puri and Gayatri (2018) and Chairunesias et al. (2018), which states that if a company experiences financial distress, managers tend to carry out management by increasing or decreasing profits. Earnings management practices are expected to save the company from financial distress. Company managers who experience financial stress who have the authority to make responsible decisions to reduce company risk tend to practice earnings management.

The results of this study are not in line with Ghazali et al. (2015) and Platt (2009) who found that company managers will practice earnings management when the company is not in financial distress and will do the opposite if the company is in trouble, which explains that the main reason why stressed companies are not involved in earnings management is simply that they exhausted their tools for earnings management and revenue management before financial difficulties and perhaps they failed to benefit from earnings management.

B. Effect of Leverage on Earnings Management

Testing the leverage variable produces a significance level of 0.000 and a regression coefficient value of 1.099. The results showed that partially leverage has a significant and positive effect on earnings management. This means that increasing leverage in a company will also increase the risk faced so that the owner will ask for a higher profit level so that the company is not threatened by liquidation which causes managers to tend to practice earnings management. Leverage shows how much the level of assets is financed by debt. Every party who has an interest in and has a contract with the company uses accounting variables in the financial statements to monitor the progress of the contract with the company. Creditors as lenders of funds to companies also base their accounting information by asking for financial ratios to be maintained, including leverage. Companies with high leverage ratios will experience difficulties in obtaining additional funds from creditors, even if the company is threatened with violating the debt agreement. Thus, in companies that have high leverage ratios, company managers tend to carry out earnings management. Thus it can be concluded that leverage affects earnings management, which means that the second hypothesis is accepted.

The results of this study are in line with Pradito and Rahayu (2015) and Wijaya and Christiawan (2014) who found that leverage has a positive impact on earnings management. These results indicate that the greater the leverage ratio, the greater the effect on earnings management. Leverage is a mechanism to avoid this default. Fulfillment of obligations must be carried out and cannot be avoided with being unable to fulfill its obligations. Earnings management measures cannot be used as a mechanism to avoid this default. Fulfillment of obligations must be carried out and cannot be avoided by earning management.

C. Good Corporate Governance Moderates the Effect of Financial Distress on Earnings Management

Testing the variable good corporate governance moderates the effect of financial distress on earnings management resulting in a significance level of 0.04 and a regression coefficient value of -0.823, which means that good corporate governance can weaken the relationship of financial distress to earnings management and is stated as quasi moderation. Because the better the implementation of good corporate governance in the company, it will increase management performance monitoring and management accountability to shareholders so that it is difficult for management to take earnings management actions. Thus it can be concluded that good
corporate governance can moderate the relationship of financial distress to earnings management, which means that the third hypothesis is accepted.

Contingency theory claims that there is no best way to lead a company or to make a decision. Instead, it is used to identify optimal forms of organizational control under different operating conditions and to explain how the organization's control operating procedures are. Based on the contingency theory, the results show that good corporate governance is effective in moderating the effect of financial distress on earnings management.

The results of this study are in line with Rice (2013) and Lestari and Wirawati (2016) which show that good corporate governance can moderate the occurrence of earnings management practices. This means that the better the implementation of good corporate governance is the smaller the earning management practice. This condition indicates that a company that implements good corporate governance will have a better level of supervision so that it will minimize the possibility of managers implementing earnings management. Effective oversight will reduce the agency problems that arise. With supervision implemented by good corporate governance, it will make managers or agents careful and transparent in running the company so that a more objective climate will be created.

D. Good Corporate Governance Moderates the Influence of Leverage on Earnings Management

The test results show that good corporate governance cannot moderate leverage on earnings management. This is evidenced by the significance level of 0.911 and the regression coefficient value of -0.04. The test results are not by the research hypothesis which states that good corporate governance can moderate leverage on earnings management. This is due to the high leverage value with a mean of 0.9107 (91.07%) so that when leverage is high and earnings management actions are carried out by high management, these actions cannot be minimized by good corporate governance. Thus, it can be concluded that good corporate governance is not able to moderate the relationship between leverage and earnings management, which means that the fourth hypothesis is rejected.

The contingency approach to management accounting is based on the premise that no universal accounting system is always appropriate to be applied to every organization, but this depends on the conditions or situations that exist in the organization. Based on the contingency approach, it is found that good corporate governance does not always have the same effect in every condition. Based on the contingency theory, other factors may interact with each other in certain conditions.

The results of this study found that good corporate governance is not able to influence earnings management actions taken by management. Management continues to take earnings management actions despite the implementation of good corporate governance because good corporate governance (proxied by the independent board of commissioners, institutional ownership, and audit quality) is only for regulatory compliance. The operational supervisory function carried out by the independent board of commissioners is not going well. Boediono (2005) revealed that based on the results of a survey by the Asian Development Bank, the board of commissioners was not independent due to the strong control of the company founders and the majority shareholder which resulted in the ineffective supervisory function of the independent board of commissioners. Companies appoint independent boards of commissioners, perhaps only for regulatory compliance but not for upholding good corporate governance. Furthermore, management continues to carry out earnings management despite institutional ownership because institutional ownership does not focus on leverage but current earnings. When institutional owners focus on current earnings while leverage focuses on the long term, managers continue to carry out earnings management to increase short-term earnings. Institutional ownership does not focus on management decisions related to high leverage which can reduce earnings management. So that institutional ownership is not able to moderate the effect of leverage on earnings management. Furthermore, the quality of auditors in a company does not affect earnings management actions taken by management. This is because the company has a desire to make financial reports look good. The results of this study are supported by Savitri and Priantinah (2019), Luhtiatno (2010), Christiani and Nugrahanti (2014), Naftalia and Marsono (2013), and Juniarta and Sujana (2015) which show that good corporate governance proxied by an independent board of commissioners, institutional ownership and audit quality do not moderate the relationship between leverage and earnings management.

VIII. RESEARCH LIMITATIONS AND SUGGESTIONS

A. Research Limitations

This study has several limitations so that the results obtained from this study are not optimal. The limitations are as follows.

1. This study shows the value of R square 0.145 or 14.5%. These results indicate that the earnings management variable is affected by 14.5% by financial distress and leverage, while the remaining 85.5% is influenced by other variables outside the variables studied in this study so that it can be taken into consideration to add other variables in further research.
The Effect of Financial Distress and Leverage on Earnings Management with Good Corporate Governance as a Moderator

2. This study has limited subjectivity in determining the disclosure index. This is because there are no standard provisions that can be used as a reference so that the determination of the index for indicators in the same category can be different for each researcher.

3. This study uses a sample with a period of three years which is considered too short compared to other studies. Also, this study only focuses on sample companies in general. This study does not focus on specific industries or specific company sizes. Findings may differ when using a specific sample of industry or company size. The magnitude of the composition of the variables used may differ between industry and firm size. Therefore, it will give a broader and more conclusive result.

B. Suggestions

Based on the results of the above conclusions, some suggestions from the researcher can be submitted as follows.

1. Company

For companies in the manufacturing sector, in particular, disclosure and implementation of good corporate governance are expected not only to pay attention to the size of the quantity of institutional ownership, audit committee, and independent board of commissioners but also to pay attention to the competencies they have related to professionalism in their respective duties and responsibilities in the company.

2. Further researchers

For further researchers, it is recommended that if you want to do research similar to this research, you should increase the number of sample variables to an observation period of more than three years so that the research is more accurate or by using other moderating variables so that generalizations can be made about moderating variables that can weaken the occurrence of financial distress and leverage on earnings management. Furthermore, the approach to measuring earnings management with a new approach by Dechow et al. (2011) is proven to increase testability, so for further research on earnings management, it is recommended to use this method.

REFERENCES


*Corresponding Author: Waode Rizky Amalia*
The Effect of Financial Distress and Leverage on Earnings Management with Good..