

## **Earnings Management in Indonesia: Are Women Always Under?**

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**Abstract:** *This study aims to find empirical evidence that the presence of gender diversity in the top management through the presence of a female president director and female finance director can reduce accrual earnings management practices and real earnings management in LQ 45 companies in Indonesia. Women have a more cautious and ethical nature in decision making, which cautious action means having a lower level of corruption so that it can suppress earnings management practices. The population of this study is all companies listed on the LQ - 45 index from 2014 to 2018. The study period is three years long, from 2016 to 2018. There are 23 (twenty-three) companies as samples in this study. Based on the results of this study, the presence of a female finance director can suppress the practice of real earnings management in Indonesia. Besides, the results of this study prove that the position of president or finance director held by women does not affect the accrual earnings management behavior in Indonesia. Also, the presence of a female president director does not affect real earnings management practices in Indonesia. The issue of gender equality is also revealed in this study. Based on the research sample, very few women held the position of female president directors in Indonesia, which is around 1.4% and 4.3%.*

**Keyword:** *accrual earnings management, real earnings management, female president director, female finance director.*

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### **I. Introduction**

One of the finance information that becomes the center of investor attention is the income statement. Unfortunately, earnings numbers can be manipulated by managers by carrying out earnings management. A study conducted by (Azizah, 2017b) with a study period of 21 years proves that there is a tradeoff (substitution) of earnings management practices. Besides, (Azizah, 2017a) proves that corporate managers in Indonesia behave opportunistically in conducting earnings management.

Earnings management practices that occur in Indonesia have indicated poor and weak governance implementation. Corporate governance that develops today relates to the issue of gender diversity at the head of the company (board diversity). In the corporate governance structure, there are two main parties directly involved in financial reporting, namely the CEO (Chief Executive Officer) and the CFO (Chief Financial Officer).

The presence of gender diversity at the top of the company is expected to limit the scope of earnings management practices. It is because gender diversity between men and women causes differences in decision making. If related to the corruption issues occurred in Indonesia, based on the annual report of the Corruption Eradication Commission (KPK) in 2016, statistically the number of corruption defendants from 2001-2016 is the majority of men, that is about 2361, or about 92% of the total corruption defendants, while the remaining 8% of defendants is women, or around 201 (KPK, 2016).

A study by Peni and Vahaama (2010) proves that women and men will act differently to deal with the same conditions. A study conducted by Gravius *et al.*, (2012) proves that women tend to be more ethical to make considerations and behavior than men.

It is expected that the presence of women at the top management of the company can reduce earnings management practices. Women have a more cautious and ethical nature in decision making, which cautious action means having a lower level of corruption so that it can suppress earnings management practices. Based on the background of the study above, the researcher is interested in conducting a study entitled "Earnings management in Indonesia: Are women always under?"

This study aims to empirically examine the gender diversity at the top management through the presence of a female president director and a female finance director having a significant negative effect on

accrual earnings management and real earnings management in LQ-45 companies in Indonesia. This research is expected to contribute toward accounting standards and rule makers to make adequate regulations to create a clean and healthy business environment because in reality the practice of earnings management is indeed carried out by companies. For users of finance statements, this study is as consideration for investors or creditors, if they want to invest in companies, to be more careful in analyzing financial statements.

## **II. Literature Reviews, Hypothesis, And Methods**

### **Nature and Nurture Theories**

Lippa (2005) and Helgeson (2012) explain gender-related theories of nature and nurture theories. Nature theory emphasizes gender diversity which is influenced by biological factors. These biological factors consist of hormonal factors, chromosomes, genes, nerve cell activities, tissue and brain structures. The theory of nurture, on the other hand, focuses on social factors. Aspects of these social factors include the influence of family members on one's mindset, both printed and electronic media, social environment, and also the role of social organizations.

The theory of nature and nurture, if related to an organization or a company, will refer to differences in the nature and behavior between men and women. A study by Archer and Mehdikhani (2004) proves that men differ from women in attitudes, that is, men will tend to be more aggressive than women. Also, a study by Byrnes *et al.*, (1999) proves that men tend to be more willing to face risks, while women tend to be careful in dealing with risks.

### **The Agency Theory**

The agency theory stated by Jensen and Meckling (1976) describes the contractual relationship between the owner (principal) and the manager (agent) as an agency relationship. In the agency theory, it is explained that each party will act according to their respective interests. In the agency relationship, the problem will arise if information is distributed unequally (information asymmetry) between the agent and the principal.

This happens in some companies in general. Managers are encouraged to maximize their interests by manipulating financial statements (following with the corridors of General Acceptance Accounting Principles) through earnings management techniques. Managers manipulate earnings management so that it follows the owners' expectations even though sometimes the finance statements do not reflect the actual condition of the company.

Roychowdury (2006) classifies earnings management into two categories, namely:

#### **1. Accrual management**

Accrual earnings management is the way managers manage earnings through accrual accounts. Accrual accounts are accounts that can be controlled by management (discretionary accruals) based on the flexibility of General Acceptable Accounting Principles (GAAP). With this accrual flexibility, managers can manage earnings by manipulating the accrual components to achieve desired earnings.

#### **2. Real earnings management**

Real earnings management is the practice of earnings management by manipulating the daily activities of companies. Three activities that managers can control to manage earnings are by giving discounts aiming to increase sales, making large-scale (mass) production aim to reduce the cost of goods sold, and reducing discretionary spending aiming to improve margins that will be reported.

### **The Effect of Female President Directors on Accrual and Real Earnings Management**

Based on the results of the study by Gravius *et al.*, (2012), between women and men, if faced with the same situation, the actions taken by women and men will be different. Women prefer to be careful in every decision or action taken, and they also prefer to avoid risky actions or decisions.

Gavius *et al.*, (2012) state that women tend to behave and think more ethical, so the decisions taken tend to be in a moderate or safe position. It is expected that with gender diversity in the position of president directors, which is the presence of women, is expected to provide obstacles to earnings management practices. A study conducted by Lakhali *et al.*, (2015) proves that the presence of women in top management was proven to reduce earnings management. Furthermore, if there are more than 3 women in the top management, it will further reduce earnings management.

Earnings management itself is not prohibited because accounting standards provide flexibility in preparing financial statements. Unfortunately, the practice of accrual earnings management or real earnings management carried out in Indonesia is opportunistic (Azizah, 2017a).

It is expected that by the presence of a female president director, and also based on the results of the previous studies which state that women are more careful, more ethical, and tend to avoid risk, it will decrease the practices of accrual and real earnings management. Thus, the first and second hypotheses are formulated as: H1: The presence of a female president director has a negative effect on accrual earnings management practices.

H2: The presence of a female president director has a negative effect on real earnings management practices.

**The Effect of the Female Finance Director on Accrual and Real Earnings Management**

A study conducted by Peni and Vahaama (2010) proves that female CFO is significantly negatively related to earnings management. A study by Gavious, *et al.*, (2012) and Barua, *et al.*, (2010) state that the presence of one of the female CEOs and female CFOs is negatively related to the level of earnings management. Therefore, the presence of a female CFO or a female CEO can suppress earnings management practices.

The results of the study by Peni and Vahaama (2010) are in line with those conducted by Gavious *et al.*, (2012). Their results prove that women prefer to avoid risk, and are more conservative when compared to men. Thus, if a woman serves in the top management position as a finance director, it is expected that earnings management practices will decrease. This is based on the nature of women who are more careful and ethical in making decisions and actions. Thus, the third and fourth hypotheses are formulated as:

H3: The presence of a female finance director has a negative effect on accrual earnings management practices.

H4: The presence of a female finance director has a negative effect on real earnings management practices.

**Methods**

The population in this study is all companies in the LQ-45 index in Indonesia. Companies in the LQ45 index are those that have good financial conditions, and high growth prospects and transaction value. The sampling technique used is purposive sampling, with criteria:

1. Companies registered consecutively in the LQ 45 index from 2014 to 2018.
2. Companies are not included in the financial services industry.
3. Companies are not classified into hospitality, travel, transportation and real estate industries.
4. The company issued audited financial statements which ended on December 31.

This study uses a discretionary accruals proxy to measure accrual earnings management (AEM) based on the *modified* Jones model (Dechow *et al.*, 1995). The discretionary accrual value in this study is absolute.

Real earnings management is proxied by three variables: (1) abnormal cash flow from operations (R\_CFO), (2) abnormal production costs (R\_PROD), and (3) abnormal discretionary costs (R\_DISX) (Roychowdhury, 2006).

The residual value of the real earnings management equation is an abnormal activity. Real Earnings Management (REM) is calculated by adding up the standardized values of the three real earnings management variables. First, the values of R\_CFO and R\_DISX are multiplied by -1 (Cohen *et al.*, 2008).

CEO (Chief Executive Officer) is the highest career path in a company. The variables in this study were proxied by using dummy variables, i.e if the director was held by a woman (CEO\_W) then it was given a value of 1 (one), and if the director was held by a man then it was given a value of 0 (zero).

CFO(Chief Financial Officer) is an executive position in a company. A CFO is responsible for managing financial risk, financial planning, and financial reporting to the president director and board of commissioners. The variables in this study were proxied by using dummy variables, that is if the finance director was held by a woman (CFO\_W) then it was given a value of 1 (one), and if the finance director was held by a man then it was given a value of 0 (zero).

The control variables used in this study refer to several previous studies. They are leverage and company size (size). Leverage is obtained by dividing the total debt by total assets. While the company size control variable (SIZE) is obtained by transforming the natural logarithm of total assets.

This study uses multiple regression analysis to examine the relationship between the dependent variable and the independent variable. The regression model used is:

Accrual-Based Earning Management Model:

$$AEM = \alpha + \beta_1 CEO\_W + \beta_2 CFO\_W + \beta_3 LEVERAGE + \beta_4 SIZE + \epsilon$$

Real-Based Earning Management Model:

$$REM = \alpha + \beta_1 CEO\_W + \beta_2 CFO\_W + \beta_3 LEVERAGE + \beta_4 SIZE + \epsilon$$

**III. Result**

The population of this study is all companies listed on the LQ-45 index in Indonesia from 2014 to 2018. The period of this study is three years long, from 2016 to 2018. Based on table 1, the number of samples in this study are 23 (twenty-three) companies.

**Table 1**  
Sample Selection Process

No.	Criteria	Number of Companies
1.	Companies listed consecutively in the LQ 45 Index from 2014-2018	40
2.	Companies not included in financial services, hospitality, travel, transportation and, real estate industries	29

3.	Incomplete data	6
4.	Companies used as samples	23
5.	Number of observations (3 years x 23 companies)	69

**First and Third Hypothesis Testing Results**

**Table 2**  
Testing Results

$$AEM = \alpha + \beta_1 CEO\_W + \beta_2 CFO\_W + \beta_3 LEVERAGE + \beta_4 SIZE + \epsilon$$

Variable	Prediction	Coefficient	Significance	Conclusion
(Constant)		-0,405	0,314	-
CEO_W	Negative	-0,014	0,824	Not significant
CFO_W	Negative	0,052	0,243	Not significant
LEVERAGE	Positive	-0,026	0,540	Not significant
SIZE	Positive	0,015	0,250	Not significant

Based on table 2, it can be explained that with a 5% confidence level, CEO\_W and CFO\_W variables have no significant effect on accrual earnings management, with p-values 0,824 and 0,243. This means that the presence of a female president director has a statistically significant negative effect on the practice of accrual earnings management, and the presence of a female president director has a statistically insignificant negative effect on real earnings management practices. Thus, the first and third hypotheses are rejected.

All control variables, namely leverage and size, are not statistically significant at the  $\alpha = 5\%$  level, which means that the size of each control variable, which is leverage and size, does not affect the size of accrual earnings management practices.

**Second and Fourth Hypothesis Testing Results**

**Table 3**  
Testing Results

$$REM = \alpha + \beta_1 CEO\_W + \beta_2 CFO\_W + \beta_3 LEVERAGE + \beta_4 SIZE + \epsilon$$

Variable	Prediction	Coefficient	Significance	Conclusion
(Constant)		30,644	0,003	-
CEO_W	Negative	0,035	0,982	Not significant
CFO_W	Negative	-5,691	0,000	Significant
LEVERAGE	Positive	-2,548	0,017	Significant
SIZE	Positive	-0,958	0,003	Significant

Based on table 3, it can be explained that the second hypothesis which states that the presence of a female president director has a negative effect on real earnings management practices is rejected or not proven. This can be seen from the significance level of 0.982 which is above the 5% confidence level.

Based on the fourth hypothesis, the results of this study have proven that the presence of a female finance director has a negative effect on real earnings management practices. The test results show the significant value of 0,000 and a regression coefficient of -5,691. Thus, the fourth hypothesis, which states that the presence of a female finance director has a negative effect on real earnings management practices, cannot be rejected.

The results of the regression test indicate that the leverage and size control variables have a significant negative effect on real earnings management practices. This means that the higher the leverage of a company, the lower the real earnings management practices. Likewise for the size of the company (size): the larger the size of the company, the lower the practice of real earnings management.

**IV. Discussion**

Based on the results of this study, the presence of female finance directors was able to suppress the practice of real earnings management. The finance director of a company has the main responsibility for managing the company's overall finances. With the presence of a female finance director, it can suppress the practices of real earnings management. This is in line with a study conducted by Gravius *et al.*, (2012) which states that women prefer to be careful in every decision or action taken and women also prefer to avoid risky actions or decisions. The results of the study by Peni and Vahaama (2010) are in line with the study conducted by Gavius *et al.*, (2012) which proves that women prefer to avoid risk compared to men.

This research failed to prove the first, second, and third hypotheses. The president director or financial director held by women does not influence the accrual earnings management behavior, and the presence of a female president director does not affect the practice of real earnings management. These are in line with a study conducted by Barua, *et al.*, (2010) which states that CEO gender does not affect earnings management.

This is possible because in the samples of this study the number of companies with female CEOs is still very small compared to that with male CEOs, so the effect is not significant.

## V. Conclusion

This study focuses on two types of earnings management, namely accrual earnings management, and real earnings management. Zang (2012) explains that a study on earnings management should not only focus on one of two types of earnings management because it results to not be able to describe overall earnings management activities.

The results of this study prove that the presence of female finance directors was able to suppress the practice of real earnings management in Indonesia. But, the positions of president director or finance director held by women do not affect the accrual earnings management behavior in Indonesia. In Indonesia itself, in most organizations, gender diversity still affects opportunities and power within an organization. Thus, the proportion of women serving in management jobs is less than that of men.

In this study sample revealed the number of female president directors and female finance directors who serve as CEOs and CFOs is less than that of men. The dominance of men is 98.6% for the position of president directors (CEOs), and 95.7% for the position of finance directors (CFOs). Some reasons underlying the lack of trust in women are time constraints. Career women will face issues related to family time. The issue of gender diversity still influences opportunities and power in an organization in Indonesia. Thus, the proportion of women serving in management jobs is less than that of men.

Moreover, the results of this study can be used as inputs for investors or auditors to be aware of earnings management practices in Indonesia. Earnings management practices need to be considered by investors in making investment decisions. This study can also contribute to accounting regulatory boards in Indonesia. Current accounting standards have not been able to prevent earnings management practices. Therefore, it is expected that there are some reforms to the regulation system that can limit or even prevent earnings management practices.

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