THE EFFECT OF CORPORATE GOVERNANCE MECHANISMS ON EARNINGS MANAGEMENT

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ABSTRACT

The objectives of the research are to find out empirical evidence of the effect of corporate governance mechanisms on the earnings management. The corporate governance mechanisms of this research are managerial ownership, concentrated institutional ownership, and audit quality which is measured by industry specialize audit firm. The target population is listed companies based on purposive sampling method. There were 80 companies meeting the criteria. Data analysis is carried out in term cross section covering financial report during 2008. The research hypotheses are tested by using multiple regression analysis. The results of this research show that; (1) managerial ownership has significantly negative influence on earnings management; (2) concentrated institutional ownership has significantly negative influence on earnings management; (3) industry specialize audit firm has no influence on earnings management.

Keywords: *corporate governance mechanisms, institusional ownership, managerial ownership, and earnings management*

INTRODUCTION

Earnings information is the part of financial statement which can be managed by opportunistic management actions to maximize satisfaction, but it can impact the stockholders and investors a financial loss. The opportunistic actions are done by choosing certain accounting policies, so the companies' earnings can be managed (increased or reduced) in accordance with their expectation. The managerial behavior to manage the earnings in accordance with the expectation is known as "earnings management". Opportunistic actions of the earnings management can inflict a financial loss of the stockholders, and the earnings information can lead to wrong investment decision. Therefore, they have to recognize the factors to control the earnings management.

U-Thai (2005) has carried out an international comparative study related to the earnings management and investors' protection in 33 countries as the sample, including Indonesia, for period 1993 to 2003. Based on the result of this research, Indonesia is categorized as the country with high earnings management and relatively low investor protection level. The deceitful phenomenon in accounting field occurred at Indonesia Stock Exchange (BEI), i.e. : the case of Kimia Farma Ltd. Co. and Lippo Ltd. Co. in 2002 which indicated earnings management practices. In 2004, Indofarma Ltd. Co. did earnings management practices by reporting overstated net income by providing higher work in process inventory than it needed, consequently, that year cost of good sold was understated, it caused the overstated report of net income (Bapepam, 2004)

Earnings management appears as a result of agency problematic impact, that is inharmonic interests between the owners and the management (Beneish, 2001). According to agency theory, this problem can be solved by good corporate governance (GCG). Corporate governance is a mechanism which can be applied by stockholders and creditors of the company to control managements' actions (Dallas, 2004). Stock ownership can be GCG. Stock ownership structure reflects the distribution of authority and domination among stockholders over operational management of a company. One of the characteristics of ownership structure is managerial ownership and institutional ownership.The underlying problem of corporate governance, the separation of ownership and control, and dispersedly held corporations described Jensen and Mecling (1976) are less common around the world. Indeed, Porter (1998) have argued that dispersed ownership represent a competitive disadvantage for the US and advocated a more concentrated ownership for competitive advantage of companies in this country. La Porta, Lopez-de Silanes and Shleifer (1999) revealed that about sixty four percent of large firms in the twenty seven richest countries have controlling shareholder and often concentrated within family. Therefore, it might be argued that the issue of ownership concentration is increasingly important in the corporate governance of enterprises. Large holders have general interest in profit maximization and enough control over the assets of the firm, and have the incentive to monitor manager. They have enough voting control to oust management through takeovers (Shleifer and Vishny, 1986). The existence of large holder lead to closer monitoring management, and this implies lesser opportunity for earning manipulation.

There are distinct differences in corporate governance contexts across countries. In general, every governance systems could be classified as market dominated or bank-dominated (Schmidt & Tyrell 1997). Market oriented

governance system generally refer to Anglo-Saxon countries (i.e. the U.S. and the U.K) where the capital market plays an important role in their company. Continental European countries and Japan have been categorized as having bank oriented governance system,and characterised by relatively concentrated ownership structures. In the case of Indonesia, as in most developing economics, some of control devices may not work as well as in countries with fully developed financial systems. The market for corporate control through take over is uncommon in Indonesia, because most companies are concentrated stock ownership. The role of banks, as a major capital provider in this country, has also been limited. Banking institutions in Indonesia are prohibited from having shares in company, therefore banks unable to closely monitor company operation. In the absence of most common corporate control mechanisms in Indonesia, relative to other countries, it also could be argued that concentrated institutional ownership are prominent in this country. The company in Asia including Indonesia are often affiliated with a business group also controlled by the same family, with the group consisting of several to numerous public and private companies (Claessen & Fan 2002). Gonzalez (2004) states ownership in the majority (97%) of Indonesia corporations is found to be concentrated by other companies (institution). From this point of view it is important to observe the effect of concentrated institutional ownership on company's earnings management.

Within the field of agency theory, investigated empirical the relationship between types of ownership and earning's management is limited. Institutional ownerships can influence the quantity of earnings management at a company, because institutional stockholders are regarded more sophisticated than individual (Rajgopal at al., 1999; Sam Han 2005). One of the most commonly investigated is the relationship between type of ownership and firm's performance with inconsistency result. Holderness and Sheehan (1988) using both ROE and Tobin's Q as performance measure, found no significant difference between majority held shareholder by single individual or entity and diffusedly held shareholder. On the other hand, a recent study by Lukviarman (2001) there is a significant difference in the performance, between majority and dispersed ownership for ROA and ROS. The research of Musnadi (2006) in Indonesia, shows that the major institutional ownerships have positive influence on financial activity at a company. Hence, this study provides an opportunity to examined potentially relationship between concentrated institutional ownership and erning's management.

The relationship between managerial ownership and firm value has been extensively explored in prior studies but they provide little guidance on how managerial ownership associated with financial reporting quality. Agency theory suggest when managerial ownership is low, the demand for accounting based performance measure increased. However, manager may impair the faithful determination of accounting number in order to meet the performance measure imposed by accounting based contract. Therefore, the quality of financial reporting may be positively with managerial ownership, since it help align the interest of the manager and shareholder. Managerial ownerships can be control mechanism toward earnings management practices (Warfield at al.,1995). On the other hand, there are countervailing incentive for manager to reduce the quality of accounting information. The voting right included in equity ownership make manager less subject to career concerns, the discipline product market, monitoring by outside shareholder, and value enhancing taheovers (Gompers et al 2003).Research in Indonesia, carried out by Budiwijaksono (2005) shows weak correlation between managerial ownerships and earnings management. Consequently, it is not clear, the research result is still inconsistent and still needs further research. Our study further provide opportunity to test conflicting prediction between managerial ownership and earning's management by using modified Jones model (1991) which modified friedland model (Utami,2005).

Within the field of research auditor external as the corporate governance mechanisms, there are two proxies that are often applied in the research of audit quality: the size of audit firm and industry specialized audit firm (here in after referred to as industry specialize audit firm). Indonesian researchers, as far as the writer sees, use the size of audit firm as the proxy of audit quality with inconsistent result of research. Therefore, the research of audit quality by using other proxies is hoped to be able to give valuable contribution for accounting and auditing researches. This research uses industry specialization audit firm as the proxy of audit quality. The use of industry specialization audit firm as the proxy of audit quality is hoped to be able to give better measurement of audit quality. The use of audit firm size as the proxy of audit quality on the previous research has got criticism after Enron case appeared which involved big accountant office namely Arthur Andersen.

Specifically, the problem statement of this research is: whether managerial ownership, institutional ownership and audit quality influence on earnings management. The result of this research is hoped to be able to give useful contribution on the development of corporate governance model, and earnings management literature.

THEORETICAL MODEL

U-Thai (2005) has carried out international comparative study between earnings quality and investor protection. The investor protection level is measured by the following proxies: (1) the quantity of aggregate value of minor stockholders' rights on the company (2) law enforcement (3) How important capital market. The result of research shows that Indonesia is categorized into the countries with low investor protection. In the countries with low investor protection level, the stockholders feel anxious about the different probability from the expected incomes. As a result, they amplify the ownership percentage on the company as one way of self protection. They can control the company by their voting power or managerial representation in order to protect their rights (La Porta and Silenz 1999). Lukviarman (2001) based on data at BEI, his research showed, there is a significant difference in the performance, between majority and dispersed ownership for ROA and ROS. The literature suggest that concentrate ownership and the role of large shareholder, will become a corporate governance mechanisms, with the absence of ' the market for corporate contrl' mechanisms, are dominant feature of developing economies (Lukviarman 2001). Hence, this study provides an opportunity to examined potentially concentrated institutional ownership as corporate governance mechanisms to mitigate earning's management.

The existence of large shareholders may restain managerial decisions. Large shareholder adderss the agency problem in that they have a general interest in profit maximization and enough control over the assets of the firm to have their interest respected (Sheilfer and Vishny, 1986). Large shareholder have the incentive to collect information and monitor management and enough voting control to oust management through takeover. The existence large shareholder thus leads to closer moniroting or scrutiny of management and this implies lesser opportunity for accruals management or earings manipulation. Dechow, Sloan and Sweeney (1996) find that earning's manipulation are more likely to have boards of directors dominated by management and less likely to have outside block holder.

Rajgopal et al (1999) has carried out research that shows negative correlation between institutional ownership and earnings management behavior, measured by absolute value of discretionary accruals. Managers confess that institutional investors have got more information than individual investors. This motivates the managers not to manage the earnings as the managers realized that institutional investors are not easy to "fool". Institutional is sophisticated investors that can perform monitoring to reduce earnings management actions. Sam Han (2005) has carried out the research on the correlation between institutional ownership and earnings management. The conclusion of his research supports the alignment effect hypothesis institutional ownership can place the stockholders to play an active role to present qualified financial report because they monitor and make the managers discipline. Research in Indonesia carried out by Wijaksono (2007) shows that institutional ownerships do not influence on earnings management. Wijaksono applies composite institutional ownerships as the measurement of institutional ownerships variable. Composite ownerships can enervate the control role on management as a result of different interests. On the other hand Musnadi (2006) has carried out research at Indonesia Stock Market (BEI). The research result shows that the greatest concentrated ownership has positive influence on the company's financial activities. It indicates that concentrated stock ownership can be as corporate governance mechanism in reducing agency problem. Concentrated ownership can effectively place the stockholder in strong position to control management in order to motivate the management to act in accordance with the stockholders' interests.

Furthermore, Munadi's research (2006) concludes that the merger of concentrated ownership give negative effects on the company's financial activities. It means that the presence of smaller blockholders potentially lead to quarrel or unfair competition as the result of their different interests. The result of Veronica's and Sidharta's research (2005) at BEI shows that the average earnings management at the companies with family ownership and non-conglomerate companies is significantly higher than other companies. Ownership by certain family group can be control mechanism if there are understanding and similar interests among them.

Based on the literature review above, it can be understood that ownership by certain group can enervate the stockholders' control role on the management if there is no harmony. This research focuses on examining the concentrated ownership by institutional as the control mechanism on the earnings management actions.

Hypothesis 1: Concentrated institutional ownerships gives negative influence on earnings management.

Theory predict that low managerial ownership implies poor aligment of interest between management and shareholders (Jensen and Meckling, 1976) and managers have incentives to pursue non-value-maximizing behavior. This gives rise to a higher demant for accounting-based constraints to mitigate manager's opportunistic behavior. To relieve these constraint, manager of low managerial ownership firms have greater incentive to manage accounting numbers, then the quality of accounting information is predictably positively

association with managerial ownership since higher managerial ownership improves the alignment of interest between managers and outside shareholders (alignment effect). Consisten with this prediction, Warfield et al. (1995) has carried out research examining the relationship between managerial ownership and earnings management by analyzing the capital market data in USA. They find out that managerial ownership has negative impact on the earnings management. Based on the result of the research, Warfield indicates that earnings reliability is the function of managerial ownership. Morck et al. (1988) has carried out research on managerial ownership and earnings management by analyzing the capital market data in USA. His research indicates that managerial ownership successfully become the mechanism to solve the agency problem and managers' moral hazard by harmonizing the manager's and stockholders' interests.

Budiwijaksono (2005) has carried out research by analyzing the capital market data in Indonesia Stock Market (BEI). Earnings management is measured by modified Jones' Model and Peasnell (2000). Peasnell (2000) focuses on working capital accrual as abnormal accrual. His research result shows that managerial ownership give low influence on the earnings management. Without considering the reality of different sizes of companies at BEI, Budiwijaksono (2005) applied natural abnormal accrual as the measurement of earnings management. It influences on the low validity of natural abnormal accrual value as the proxy of earnings management. In fact, the size of companies at BEI is varitype, in order to get accurate measurement on earnings management; abnormal accrual should be rationed on the company size, as reflected on modified Jones' Model and Peasnell (2000). For cases in Indonesia, Utami (2005) and Nuryaman (2008) prove that ratio value of abnormal accrual on sales (modified Friedlan's Model, 2001) gives more accurate measurement result, as it gives the best explanatory power. This research is different from Wijaksono (2005) in case of proxy used to measure the earnings management. This research applies modified Jone's Model, which is then rationed toward sales value as the size of company (Friedlan's model). To determine abnormal accrual is focused on working capital accrual (Peasnell 2000).

Hypothesis 2: Managerial ownership gives negative influence on the earnings management.

The role of external auditor is professionally giving independent judgment on the reliability and naturalness of the company's financial report performance. External auditor can be as control mechanism on the management in order the company performs reliable financial information and free from deceitful accounting practices. This role can be gained if the external auditors give qualified audit services. There are two proxies which can be applied to describe the quality of audit variable, those are the size of audit firm (KAP) and the industry specialize audit firm.

Zou and Elder (2001) state that the industry specialize audit firm is the dimension of audit quality, as the industrial knowledge and experience of the auditors are some elements of auditors' competences. Their research on analyzing companies' data from 1996 to 1998 in USA, concludes that: (1) the quantities of companies' earnings management audited by Big six audit firms are lower than the companies audited by non-Big six audit firms; (2) the quantities of companies' earnings management audited by the industry specialization audit firm are lower than the companies audited by the non-industry specialization audit firm. The result of Carcello's et al research (2004) from 1990 to 2001 in USA indicates that there is significantly negative correlation between the industry specialization audit firm and the manipulation on financial report, and the negative correlation is weaker for the bigger companies.

Former research in Indonesia concerning to audit quality as corporate governance mechanism, produced inconsistent results. Ardiati (2003) concludes the size of audit firm as the proxy of audit quality can moderate the relationship between the earnings management and the stock returns. Mayangsari (2003) examines the influence of the industry specialize audit firm on the integrity of financial report. The financial report integrity is measured by conservative index; the result indicates that the industry specialization audit firm give positive influence on the financial report integrity. Whereas, Veronica's and Sidartha's research (2005) on the research period 1995-1996 and 1999-2003, conclude that the size of KAP insignificantly influence earnings management.

Hypothesis 3: The industry specialize audit firm gives negative influence on earnings management.

METHODOLOGY

Research Population and Sample

The target population of the research is the active public corporation of manufacturing sector in 2008; there are 137 corporations (www.Bapepam.com). From the population above, the sample of listed public company is obtained based on four certain criteria, as follows; (1) having annual book closed on 31 December 2008; (2) having positive equity for 2008; (3) having annual financial report in 2008 at BEI.

Definition and Operational Variable Research

Concentrated Institutional ownership (MIST) is the stock ownership of institution. In this research, concentrated institutional ownership is represented by the greatest number of stocks owned by an institution (non individual omnerhip). Managerial Ownership (MNJD) is the stock ownership of managerial group. In this research, managerial ownership is measured by the proportion of stocks owned by manager and commissioner of a company (Sam-Han, 2005). It uses dummy variable : 1 for the company with managerial ownerships, and 0 for reverse. The industry Specialize audit firm (AUDIT) the industry specialization audit firm describes the auditors' competence and experience on certain industrial sector. The industry specialize audit firm in this research is with the % client volume on KAPi (Neal and Riley, 2004). Based on Crashwell's definition (1995), manufacturing industries at BEI are classified into three categories; (1) basic and chemical industry; (2) various industry; (3) consumption goods industry. Firm Size; this analytic model includes the control variable of firm size that is log of total sales (LOGPNJ). Based on previous research, firm size has negative correlation on the earnings management (Nuryaman 2008, Veronica 2003, Marrachi 2001).

Earnings Management (ML) is the condition when management interferes in the process of writing financial report for external party in order to increase or reduce earnings report. Management can apply loosen accounting method, discretionary policies to accelerate or postpone the costs and incomes, in order that the company's earnings can be managed in accordance with their expectation. Dechow at al (1995) state that modified Jones' model has better ability to detect earnings management than the model of Healy's, De Angelo's, Jones' and Decow's and Sloan's model. This research applies modified Jones' model to determine earnings management, by cross section approach developed by Peasnell et al (2000). This approach is applied to determine the abnormal accruals value, focusing on the components of working capital accruals. Abnormal accruals are calculated, as follows:

$$AA\ i = WC\ i\ [\hat{w}_0 + \hat{w}1\ (\Delta\ REV\ i - \Delta\ REC\ i)]$$

Note :

AA : abnormal accruals, discretionary accruals

$\hat{w}_0$, $\hat{w}_1$: regression estimation from $\hat{w}_0$, $\hat{w}_1$ at the equation of working capital accruals estimation

Δ REC i : account receivable changes in one year

Δ REV i : sales changes in one year

The parameter estimation ŵ0 and ŵ1 is gained from the following equation:

$$WC\ i = \hat{w}0 + \hat{w}1\ \ \Delta\ REV\ i + vi$$

Note :

WC i : Company's working capital accruals, as the proxy of total accruals

Δ REV i : Sales changes

$\hat{w}_0 + \hat{w}_1$: Regression coefficient

vi : Error (residual regression)

Working capital accruals (WCi) is defined as non-cash current asset changes reduced by current liabilities changes, thus:

$$WC\ i = (\Delta\ AL - \Delta\ Kas) - \Delta\ HL$$

Note:

WC i : company's working capital. As the proxy of total accruals at t-period

Δ AL : current assets changes at t-period

Δ HL : current liabilities changes at t-period

Δ Kas : cash current assets changes and cash equivalent at t-period

Based on Utami's research (2005) and Nuryaman (2008), it is advised to apply modified Friedlan's model to measure the earnings management at BEI, because this model contribute the best explanatory power. The measurement of earnings management variable on this research is, as follows:

Earnings management = the ratio between abnormal accruals (AAi) and sales

Considering that this research is not to examine earnings managerial type (positive or negative), so abnormal accruals value which is used, is absolute discretionary accruals value.

Data Collecting Method

The data used in this research is quantitative data gained from Capital Market Reference Centre at BEI in the form of 2008 financial reports of industrial company manufacturing sector provided there.

Analytical Model Design

$$MLi = a + b_1\ KMNJD_i + b_2\ KIST_i + b_3\ AUDIT_i + b_4\ LOGPNJ_i + \varepsilon_{1.i}$$

Note:

MLi : Ratio between absolute abnormal accruals and sales. Applying absolute value because the focus of this research is the quantity of earnings management, not direction (positive or negative)

a_1 : Constanta

$b_{1,2,3,4}$: Variable coefficient

KMNJDi : Stock managerial ownership, 1 if firm that has managerial ownership, 0 if otherwise

KISTi : The greatest stock institutional ownership percentage of total outstanding stock

LOG PNJ_i : Log of total sales value that is the proxy of firm size

AUDITi : Industry specialization audit firm, that is volume (in percent) audit firm's client from the total clients in industrial group.

ε_1 : residual of error

i : the 'i' order of the company

RESULT AND DISCUSSION

Descriptive Statistics

As presented on Table 1, the sample of this research is 80 companies or 58.7% from 137 target population of this research. This number is determined in accordance with annual report gained by the writer, and fulfillment of certain sample criteria.

Table 1: The Percentage of Sample Company Based on Industrial Type

NO	Group and Sub Manufacturing Industry	Number of Company	Number of Sample	Percentage of Sample
1	Basic and Chemical industry	53	26	49
2	Various Industry	45	23	51
3	Consumption Goods Industry	39	31	79
	Total	137	80	58

On Table 2, it is seen that stock ownership by management at manufacturing industries is relatively low. The company whose managerial ownership are 26 companies (in average 2.23 %, minimum 0.02 % and maximum 26 %). The mean management ownership number Indonesia companies (as sample) are 0.72 %. The institutional ownership is relatively high. The average of institutional ownership is 50.5 % with standard deviation 2.38 %.

Table 2: Descriptivr Statistics

	N	Minimum	Maximum	Mean	Standard Deviation
ML	80	.00	2.05	.1376	.33358
LOGPNJ	80	4.30	8.85	6.0780	.75360
KMNJD	80	.00	1.00*	-	-
KINST	80	3.00	98.00	50.5625	23.83904
AUDIT	80	1.22	18.29	7.4390	6.16541
Valid N (liswise)	80				

Notes : ML = earnings management ; LOGPNJ= Firm's size; KMNJD =Managerial ownership as dummy variable. 1 if company with managerial ownership, 0 if otherwise. *) Company whose managerial ownersip are 26 companies . KINST = Concentrated Institutional ownership. AUDIT = Industry specialize audit firm

Table 3 shows the percentage of market segment of audit service by the big tent audit firm on the industry manufacturing sector. KAP Purwanto, Sarwoko and Co. governances the highest market segment with 18.29 %, followed by the second greatest governance with 12.19 % KAP Osman Bing Satrio and co. and the rests are just 5 % or less.

Table 3: Percentage of Client Volume according to audit firm

Audit Firm's name	**Number of Client**	**Percentage (%)**
Purmantono, Sarwoko & Co.	15	18.292668
Osman Bing Satrio & Co.	10	12.19512
Haryanto Sahari & Co.	5	6.09512
Paul Hadiwinata, Hidajat, Arsono & Co.	5	6.09512
Kosasih & Nurdiyaman	5	6.09512
Aryanto Amir Yusuf & Mawar	4	4.87805
Sidharta & Sidharta Widjaya	4	4.87805
Adi Jimmy Arthawan	3	3.65854
Mulyamin Sensi Suryanto	3	3.65854
Tjahjadi, Phradono & Teramihardja	3	3.65854
Johan Malonda Astika & Co.	3	3.65854
Ngurah Arya & Co.	3	3.65854

Table 4 shows that the average value of abnormal accruals (ML) is 0.1376 or 13.76 % from sales with the minimum value 0.00143 or 1.0034 % and the maximum 2.05 or 205% from sales. The standard deviation rate of earnings management is 33.3%, this rate is relatively high reflecting that the earnings management at the companies is varied.

Table 4: Earnings Management of Manufacturing Company

	Minimum	Maximum	Mean	Standard Deviation
Earnings Management	.00	2.05	.1376	.33358

Note: Earnings management = the ratio between abnormal accruals and sales.

Multivariate Testing Result

To get efficient and accurate regression result, the data must be free of classic assumption violation. Based on data tested on the three rules underlying classic assumption, the result is that the tolerance value is higher than 0.10 (TOL > 0.10) and the value of variance inflation factor (VIF) is less than 10 (VIF < 10). It can be concluded that by analytical model, there is no multi-collinear; (b) homoscedastic data testing by Glejser test (Gujarati, 2003). All regression coefficient of independent variable are not significant, as the value of SIG > 0.05. Thus it can be concluded that there is no homoscedastic: (c) next, normality testing by Kolmogolov-Smirnov test shows that the value of SIG is 0.05. It can be concluded that the research data has relatively normal distribution.

Table 5 for simultaneous test that is :

Table 5: Simultaneous Test

Regression Model	R	Adjusted R2	F	Signif.
$ML_{it} = a_1 + b_1\ KIST_{it} + b2\ KMJD_{it} + b3\ AUDIT_{it} + b4\ LOGPN_{1\ it} + \varepsilon_{1.it}$	0.413	0.171	3.740	0.008

Table 5 shows that adjusted square R is 0.171, it indicates that independent variables of managerial ownership, institutional ownership, audit quality with the proxy of industry specification audit firm, and the size of company are able to clarify 17.1 % variation of earnings management. It seems that the F-testing shows significance level at 0.008 or significance at level 0.1 so the analysis can be continued.

Table 6 shows summary of regression coefficient of whole independent variable on earnings management.

Table 6: The Summary of Variable Regression Result of Managerial ownership, Institutional ownership, Industry Specialization audit firm , Firm size on Earnings Management

Model		Unstandardized Coefficients		Standardized Coefficients	t	Signif.
		B	Std. Error	Beta		
1	(Constant)	.874	.210		4.170	.000
	KINST	-.002	.001	-.195	-2.187	.049
	AUDIT	.001	.004	.029	.252	.802
	KMNJD	-.060	.033	.043	-1.812	.097
	LOGPNJ	-.118	.036	-.377	-.377	.002

Note: ML= earnings management; KINST = Institutional ownership; AUDIT = Industry specialize KAP (Audit firm). KMNJD=Manajerial ownership. LOGPNJ= Firm's size

Table 6 shows that regression coefficient of institutional management variable is -0,020 with significance level at 0.049. The coefficient has negative sign that point out to negative correlation, in accordance with the hypothesized theory. Concerned to significance level, hypothesis 1 that states that concentrated institutional ownership has negative influence on the earning management is accepted at significance level 0.049. The research result indicates that greatest institutional ownership can be applied as corporate governance mechanism to control earnings management practices at company.

Table 6 shows that regression coefficient of managerial management variable is -0,060 with significance level at 0.097. The coefficient has negative sign that point out to negative correlation, in accordance with the hypothesized theory. Concerned to significance level, hypothesis 2 that states that managerial ownership has negative influence on the earning management is accepted at significance level 0.097. The research result indicates that management ownership can be applied as corporate governance mechanism to control earnings management practices at company.

Regression coefficient of industry specialization audit firm (Table 6) is 0.001 with significance level at 0.802. The coefficient has positive sign, it indicates that industry specialization audit firm has low influence on earnings management; it does not meet the theory. Concerning to its significance level, it indicates that industry specialization audit firm does not influence earnings management. Thus, hypothesis 3 that states industry specialization audit firm has negative impact on earnings management is rejected at the significance level 0.1. It proves that audit quality with proxy of industry specialization audit firm is unable to limit the quantity of earnings management, it describes that audited by big audit firm or audit firm with big market segment does not guarantee higher audit quality, because it is unable to reduce earnings management significantly.

Some reasons why there is no negative influence between industry specialization audit firm and earnings management are: (1) perhaps industry specialize audit firm is not good proxy for audit quality in Indonesia; (2) Director of Accountant and Appraisal Development, Department of Finance (2005), based on inspection result of audit firm and Public Accountant 2003 and 2004 period reports that Public Accountant is unable to comprehend Financial Accounting Standard (FAS). Those disabilities can demotivate audit firm to reveal and limit earnings management practices at company.

Regression coefficient of company size (Appendix 6) is -0.118 with significance standard 0,037. Concerned to significance level, the size of company has strong influence on earnings management at significance level 0.05. The Coefficient has negative sign indicating the bigger size of company, the lower earnings management is. It meets the theory.

CONCLUSION AND RECOMENDATION

Conclusion

Managerial ownership has negative influence on earnings management; it indicates that managerial ownership can be as corporate governance mechanisms for company in order to limit earnings management in the company. Concentrated institutional ownership has negative influence on earnings management; it indicates that greatest institutional ownership can be as corporate governance mechanism for company in order to limit earnings management in the company. Audit quality with proxy of industry specialize audit firm has positive and insignificant influence on earnings management. It describes that audited by big audit firm or audit firm with big market segment does not guarantee higher audit quality. In the context of correlation between audit

quality and earnings management, perhaps audit quality with proxy of industry specialize audit firm is not good proxy for audit quality in Indonesia

Recommendations

For Next Researchers, to examine the correlation between audit quality and earnings management, the next researchers are advised to use other proxies of audit quality, such as; proxy of failure audit. For Operational Interests : (1) Stock ownership by managerial and Concentrated institutional ownership can be corporate governance mechanisms on earnings management; (2) For accountant practitioners or audit firm, it is recommended to develop their competences by performing various training for their auditor or giving additive experience by field study, including the development of competences and comprehensions on FAS.

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