Anti-Corruption Disclosure and Audit Quality on Earnings Management

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Abstract

This study aims at examining the effects of anti-corruption disclosure and audit quality on earnings management. The Audit quality is proxied by the public accountant firm size and auditor specialization. In the analysis, two controls variable are added, namely return on assets and leverage. The sample of this study includes mining companies that were listed on the Indonesian Stock Exchange (IDX) in 2015-2019. The sample is selected by using the purposive sampling method. The results show that there is a significant negative relationship between anti-corruption disclosure and earnings management, which means as there are more disclosures being made by companies that indicates transparency and integrity activities, the possibilities of earnings management would decrease. However, audit quality does not significantly influence the earnings management because only the auditor specialization has a negative effect on earnings management.

Research purpose:
This study aims at examining the effects of anti-corruption disclosure and audit quality on earnings management.

Research motivation:
This study is important because the negative consequences could occur if company commit corruption as loss of trust from stakeholder could become a concerning problem for the firm in the future. Anti-corruption disclosure not only prevents acts of corruption, but it also provides transparency and accountability by increasing public awareness.

Research design, approach and method:
This research is a quantitative research, using secondary data and utilizing regression analysis to determine the relationship between anti-corruption disclosure, audit quality, and earnings management.

Main findings:
Anti-corruption disclosure has a negative significant relationship with earnings management which means as more disclosures were made by companies, indicating transparency and integrity activities, the possibilities of earnings management could decrease.

Practical/managerial implications:
This study has several implications. Anti-corruption disclosure could prove the firm's legitimacy for the stakeholder, showing that the company is able to hold its integrity and accountability through its transparency.

Keywords: anti-corruption disclosure, audit quality, earnings management

1. INTRODUCTION

The mining sector is one of the supporters of the growth and economic development of a country. As a provider of energy resources, *Mining* is an industrial sector that often gets the government's attention. However, the COVID-19 pandemic has harmed the mining sector proven. Throughout 2019 it was reported that the mining sector index negative growth of 12.83% (Kontan.co.id, 2020). In 2020, the mining sector did not experience a full recovery as seen from growth tax revenue from the mining sector is ranked the lowest among other primary sectors, namely -43.72%.

As part of one of the leading industrial sectors in Indonesia, Mining indeed cannot be separated from various problems that occur. Until 2021, the Executive Director of the Indonesian Forum for the Environment (WALHI), Nur Hidayati said that her party considered that the mining industry in Indonesia does not meet environmental standards. Not infrequently, problems arise as a result of mining activity. Starting from licensing issues, conflicts with local residents to pollution from mining tailings waste and coal dust (kontan.co.id, 2021). The problem of taxation is also not over, considering the number of mining companies that

do not have a Taxpayer Identification Number (NPWP) despite having been in business for many years. Not only that, but the mining sector is also vulnerable to problems with outstanding finance. In 2016, PT Timah (Persero) Tbk was suspected of providing a fictitious financial report in the first semester of 2015. Activities of this fictitious financial report were carried out to cover up the financial performance of PT Timah, which continues to be alarming. PT Timah's financial condition for the past three years has been unsanitary (starting from 2013). The inability of the Board of Directors of PT Timah to get out of the loss trap has resulted in the handover of 80% of the mining area owned by PT Timah to business partners (Tambang.co.id, 2016). In the same year, the Directors of PT Cakra Mineral Tbk (CKRA) have been reported to the Indonesia Stock Exchange (IDX) and the Financial Services Authority (OJK) due to cases of embezzlement, accounting manipulation as well as issues related to disclosure falsely directed by the director. CKRA's board of directors has deliberately inflated the value of CKRA assets by falsely consolidating reports finances as well as overestimating the value of the paid-up capital of the two mines so that investors cannot make the right investment decisions and cause investors to suffer significant losses from disclosure which has been submitted through IDX and OJK platforms (Beritalima.com, 2017).

These are just a few of the many cases that illustrate that the company can influence the presentation of financial statements to show optimal performance and achievement results with overriding applicable laws and regulations. Financial statements used as one of the essential components in decision-making can create pressure for management to strive to meet the expectations owned by stakeholders. Every stakeholder of course want the company to be responsible for the resources that have been entrusted to the company. Components in the financial statements can provide information on the company's success in managing resources that power. Profit and raise the stock price is one component that investors stakeholders often use to measure the effectiveness of fund management that has been given to the increase in returns to be received. Therefore, Financial statements must be presented fairly and free from manipulation or known as financial statement fraud.

One of the actions to carry out financial statement fraud is earnings management or earnings management (Syahputra, 2019). Earnings management of the existence of information asymmetry allows management to modify earnings so that the profit information in the financial statements will show a higher value provide a pleasing effect to investors on the performance of management in a company. Earnings modification can be done by management by choosing accounting policies from a particular standard to maximize the welfare of the parties' management and the value of a company (Sosiawan, 2012). This

company's activities have proven to impact the company internally and have an external impact on the company. Fraud perpetrated by the company will harm the company because it will reduce stakeholder trust in the company. So the company must show the form of responsibility for the trust that stakeholders have given in the economic aspect and socially and environmentally.

The company discloses its Corporate Social Responsibility (CSR), which is used to provide accurate information in ensuring that the company can be responsible before the stakeholders. Inside it, the company discloses anti-corruption activities or Anti-Corruption Disclosure that are used to provide transparency to corporate accountability, raise public awareness, and attract the attention of other companies to adopting anti-corruption principles (Karim *et al*, 2016). Reporting an anti-corruption program shows that the company is responsible for employee behaviour and recognizes the negative consequences that can affect their reputation, integrity, and legitimacy if they are involved in corruption (ACCA, 2008).

The existence of information asymmetry can be overcome by conducting an audit. Auditing is a process to reduce the misalignment of information between managers and shareholders by using outside parties to validate financial statements (Meutia, 2004). In practice, the audit must have good quality to act as a deterrent to effective earnings management because management's reputation will be destroyed, and the company's value will decrease if this inaccurate reporting is detected and revealed (Ardiati, 2005). Therefore, auditor industry specialization plays a vital role because auditors who have experience in a particular industry will be able to detect errors in client data in that industry than auditors who are not focused on a particular industry and have a better experience than non-specialized auditors (Christiani & Nugrahanti, 2014).

2. METHODOLOGY

This research is quantitative research, with the data source used in this research is secondary data. The secondary data in this study are sustainability reports, annual reports, and financial reports audited and listed on the Indonesia Stock Exchange (IDX). This study uses a population of mining sector companies listed on the IDX in 2015-2019. The mining sector is used because mining companies support the growth and development of a country's economy. Not only that, but the mining sector is also vulnerable to significant financial problems.

Meanwhile, the funds spent on corporate social responsibility (CSR) activities are considerable. This indicates that mining companies want to gain legitimacy from stakeholders so that the company's sustainability can be maintained. The sampling technique used in this study was the purposive sampling technique. Therefore,

a sample of companies was selected with companies that met the following criteria:

1. Mining companies registered and publishing annual reports on the IDX website for 2015-2019.

2. Mining companies that publish sustainability reports in 2015-2019.

3. Mining companies that have complete financial data for 2015-2019 required for variable measurement.

Operational Definition of Variable

1. Earnings Management

According to (Wirakusuma, 2016) Earnings management is a deliberate process, with the limitations of financial accounting standards to direct earnings reporting at a certain level. This process shows the conditions in which management intervenes in preparing financial statements for external parties so that they can increase, level, and reduce profits. With this intervention, of course, stakeholders do not get accurate information about the company, which impacts decisions that are not suitable for the company's sustainability. Therefore, this act is categorized as a fraud because the manager of a stakeholder company consciously gets false information even though academics assess earnings management as the freedom of a manager to choose the accounting method used when recording information in financial statements (Sulistyanto, 2008).

According to Scott (2015) there are four patterns of earnings management, namely:

Taking a bath

This pattern occurs when the organization experiences specific pressures caused by reorganization, such as CEO change. Taking a bath is done by reporting significant losses. This action is expected to increase profits in the future.

Income Minimization

The pattern occurs when the organization experiences a very high level of profitability, or the organization predicts that in the future, earnings will decrease significantly so that the current period's profit will be reported to be lower than the actual profit. This action can be done by advertising costs, R&D costs, or the write-off of intangible assets.

Income Maximization

The pattern that occurs is that the organization experiences a deficient level of profitability. The income maximization action aims to report high net income for a bigger bonus. This pattern is carried out by allocating deferred costs or period changes and accelerates the recording of income.

Income Smoothing

The organization carries out this pattern by making consistent profits in financial statements to reduce fluctuations in profits that are too extreme. This is because stable profits indicate an organization that is not risky and attractive to investors.

The dependent variable in this study is denoted by the letter Y, namely Earnings Management. Earnings management or earnings management can occur due to information asymmetry that allows management to manipulate earnings. Earnings management is done by playing with the accrual components in the financial statements because the accrual component can be played with numbers through the accounting method used under the wishes of the person who records and prepares financial statements. The accrual component is a component that does not require physical evidence of cash so that playing with the size of the accrual component does not have to be accompanied by cash received or issued by the company (Sulistyanto 2008). Stubben (2010) introduced the Revenue Discretionary Model to detect earnings management. There are two formulas in the discretionary revenue model used as a detection model for earnings management. The first is the revenue model, this model focuses on revenues that have a direct relationship with receivables. The second is the conditional revenue model, this model was redeveloped with the addition of company size (size), age of the company (age), and gross margin (GRM), which allegedly can be used in detecting accrual earnings management regarding credit related to receivables. Firm size is a proxy for financial strength. Firm age is a proxy for the firm's stage in the business cycle. As a proxy for the operational performance of the company's comparison with competing companies, the gross margin is used. Measuring and calculating accrual earnings management using the revenue discretionary model approach is explained as follows:

Revenue Model
$$\Delta AR_{it} = \alpha + \beta 1\ \Delta R1\_3_{it} + \beta 2\ \Delta R4_{it} + e \ \dots\dots\dots\dots(1)$$
Conditional Revenue Model
$$\Delta AR_{it} = \alpha + \beta 1\ \Delta R_{it} + \beta 2\ \Delta R_{it} \times SIZE_{it} +$$
$$\beta 3\ \Delta R_{it} \times AGE_{it} + \beta 4\ \Delta R_{it} \times AGE\_SQ_{it} +$$
$$\beta 5\ \Delta R_{it} \times GRM_{it} + \beta 6\ \Delta R_{it} \times GRM\_SQ_{it} +$$
$$e \ \dots\dots\dots\dots(2)$$

Description:

AR = Year-end receivable

R1_3 = Revenue in the first three quarters

R4 = Revenue in the fourth quarter

SIZE = Natural log of total assets at the end of the year

AGE = Age of the company

GRM = Gross Margin

e = error

2. Anti-Corruption Disclosure

The independent variable in this study is denoted by the

letter x, namely Anti-Corruption Disclosure (X1). Companies are encouraged to implement strategies to combat corrupt activities (Hills et al., 2009). Therefore, corruption prevention can be used as an additional form of disclosure for corporate accountability to stakeholders and communicated to all company parts (Khaimainy and Asih, 2019). In 2010, Transparency International stated that assessing and mitigating corporate risks related to bribery and corruption should be part of a company's approach to social responsibility. Reporting on an anti-corruption program signal that companies are responsible for the behavior of their employees and that they recognize the negative consequences that could affect their reputation, integrity, and legitimacy if they engage in corruption (ACCA, 2008). When management succeeds in carrying out anti-corruption disclosures, the possibility of earnings management will decrease, and the company's operational activities will be more accountable because they try to be transparent in presenting financial reports (Khasanah and Kusuma, 2020). The basis for measuring anti-corruption disclosure uses an index released by the Global Reporting Initiative (GRI) G4, which consists of three categories, namely

1. G4-SO3: Total number and presentation of operations assessed for risks related to corruption,

2. G4-SO4: Communication and training on anti-corruption policies and procedures, and

3. G4-SO5: Proven incidents of corruption and the action to be taken.

Measurement of the disclosure index is carried out using content analysis on the companies annual report with a value of "1" and "0" when the company reports or does not report the disclosure item, respectively (Haniffa and Cooke 2005).

3. Audit Quality

The second independent variable in this study is namely Audit Quality (X2). Meutia (2004) defines *auditing* as a process to reduce misalignment of information contained between managers and shareholders by using outside parties to validate financial statements. Meanwhile, DeAngelo (1981) defines *audit quality* as the combined probability of detecting and reporting errors that material in the financial statements. Audit quality is seen as the ability to enhance the quality of the company's financial reporting. High audit quality is expected to increase investor confidence. Earnings management occurs due to the information asymmetry between the principal and agent, which indicates the need for an independent party. In this case, the auditor is a party capable of intermediary for the interests of the two parties. Ardiati (2005) states that high-quality auditing acts as a deterrent to effective earnings management because management's reputation will be destroyed, and the company's value will decrease if inaccurate reporting is detected and revealed. In this

study, audit quality is seen from the size of the public accounting firm and auditor specialization.

Audit quality is proxied by two variables, namely the public accountant firm's size (Big-4 and Non-Big-4) and the auditor industry specialization (Gerayli et al, 2011). DeAngelo (1981) states that the large firm (Big-4 accounting firms) is perceived to be conducting audits with higher quality than small KAPs (non-big-4 accounting firms). This is because large KAPs have many clients, so that when they have to release one of their clients, the Big KAPs are still able to maintain their independence. Audit quality is seen as the ability to enhance the company's financial reporting quality and is expected to increase investor confidence. According to Christiani and Nugrahanti (2014), auditors who have experience in a particular industry will be able to detect errors in client data in that industry than auditors who are not focused on a particular industry and have a better experience than auditors who are not focused on a particular industry. Non-specialized auditors. Therefore, the quality of an audit is considered to have a negative effect on earnings management which shows that the better the audit quality of the company, the lower the probability of earnings management occurring. Measurement of the public accountant size is carried out if Big-4 audited the company, it would be given a value of 1 and 0 if not. Meanwhile, auditor specialization is seen in classification based on the percentage of companies audited by the same auditor in the same industry. The majority of auditors in the industry will consider as specialized auditors. This study proxies auditor specialization with a dummy variable. If a specialized auditor audits the company, it will be given a value of 1 and 0 otherwise.

4. Control Variable

This study utilized the control variable profitability (ROA) and leverage. The profitability was measured using net income divided by total assets (Nalarreason et al. 2019; Sun et al. 2010). Meanwhile, the leverage used in this research was measured by dividing the total liabilities by total assets.

3. RESULTS AND DISCUSSION

This study utilized regression analysis to determine the relationship between anti-corruption disclosure, audit quality, and earnings management.

$$EM_{it} = \alpha + \beta1\ \Delta ACD_{it} + \beta2\ \Delta BIG4_{it} + \beta3\ \Delta SPE_{it} + \beta4\ \Delta ROA_{it} + \beta5\ \Delta LEV_{it} + e$$

Description:

EM = Earnings Management

ACD = Anti-corruption disclosure

BIG4 = Big-4 (Public Accountant Firm Size)

SPE = Auditor Specialization

ROA = Return on Assets

LEV = Leverage

e   = error

Data Description

Table 1: Descriptive Statistic Test

	N	Minimum	Maximum	Mean	Deviation
ACD	55	0	1	0,36	0,48548
SPE	55	0	1	0,40	0,49441
BIG4	55	0	1	0,78	0,41682
ROA	55	-0,70450	0,28984	0,0377	0,12646
LEV	55	0,00246	2,03056	0,5918	0,34186
EM	55	-0,20296	0,13545	0,0004	0,04435
Valid N (listwise)	55				

Table 1 shows that the average earnings management (EM) has a value of 0.0004, a standard deviation of 0.04435, a maximum value of 0.13545, and a minimum value of -0.20296.The anti-corruption disclosure (ACD) has an average value of 0.36, a standard deviation of 0.48548, a maximum value of 1, and a minimum value of 0. The average values of auditor specialization (SPE) is 0.40, a standard deviation of 0.49441, a maximum value of 1, and a minimum value of 0. The public accountant firm size (BIG4) has an average value of 0.78, a standard deviation of 0.41682, a maximum value of 1, and a minimum value of 0. Profitability (ROA) has an average value of 0.0377, a standard deviation of 0.12646, a maximum value of 0.28984, and a minimum value of -0.70450. The average value of leverage (LEV) is 0.5918, a standard deviation of 0.34186, a maximum value of 2.03056, and a minimum value of 0.00246.

Classic Assumption Test

The classical assumption test was carried out before performing multiple linear regression analysis to determine the sample's ability to represent the population as a whole. The classical assumption tests performed in this study were the normality test, multicollinearity test, autocorrelation test, and heteroscedasticity test.

The normality test was conducted to determine whether the data were normally distributed or not. The normality test was carried out using the Kolmogorov-Smirnov (K-S) non-parametric statistical test. Based on the results of the Kolmogorov-Smirnov non-parametric statistical test, it is known that the data that is the research sample is normally distributed because of the significance value (Asymp. Sig.) is 0.200 (> 0.05) greater than 0.05.

The results of the multicollinearity test show that the tolerance value is between the values of 0.519 to 0.914, and the VIF (Variance Inflation Factor) is between the values of 1.094 to 1.927. All independent variables have tolerance values above 0.10 and VIF values below 10. It can be concluded that there is no multicollinearity between independent variables in the regression model.

The results of the autocorrelation test using the Durbin Watson test showed that the Durbin Watson value was 1.712 with dL of 1.812 and dU of 1.7681. For this reason, it can be concluded that the Durbin Watson statistical value in this study is dU < d < 4-dU. It can be concluded that there is no autocorrelation.

The results of the heteroscedasticity test using the glesjer test show that in the regression model, there is no heteroscedasticity because the variables Anti-Corruption Disclosure, Public Accountant Firm Size, Auditor Specialization, Return on Assets, and Leverage has a significance value above 0.05.

Hypothesis Testing

The test results show the Adjusted R Square value of 0.221 or 22.1%. This explains that Anti-Corruption Disclosure and audit quality can explain 22.1% of the effect of earnings management. In this study, the remaining 77.9% was influenced by other variables not examined in this study. The results of the F test show a significant value of 0.004 which means it is smaller than 0.05 (0.004 <0.05). Furthermore, it can be concluded that the regression model formed with the independent variable is anti-corruption disclosure and audit quality, and the dependent variable, namely earnings management, is meeting the goodness of fit.

Table 2. Result of Hypothesis Testing

	Unstandardized Coefficients		
	B	t	Sig.
(Constant)	0,071	3,041	0,004
ACD	-0,029	-2,562	0,014
SPE	-0,026	-2,080	0,043
BIG4	-0,006	-0,411	0,683
ROA	-0,170	-3,290	0,002
LEV	-0,064	-2,965	0,005

R-Square = 0,293; Adjusted R^2 = 0,221; F-test = 4,056; Sig F = 0,004

Anti-Corruption Disclosure and Earnings Management

This study shows that the Anti-Corruption Disclosure variable has a significance value of 0.014 (<0.05) H0 is rejected and H1 is accepted. It can be concluded that Anti-Corruption Disclosure affects earnings management. This study is in line with Khasanah and Kusuma (2020), who found that Anti-Corruption Disclosure negatively affected earnings management. The company uses Anti-Corruption Disclosure to reveal that it can maintain accountability and transparency in carrying out its activities. This is because the Anti-Corruption Disclosure provides information on the strategies undertaken by the company in avoiding fraudulent actions. The disclosure is closely related to corporate social responsibility that the company is trying to gain legitimacy from stakeholders that the company can maintain public trust in each of its activities. The legitimacy obtained by the company can be in the form of a good image in front of stakeholders and consumers or the company's sustainability, which tends to be maintained because the company has integrity in carrying out its activities. In addition, according to Joseph *et al* (2016), Anti-Corruption

Disclosure is also an indication that the company can be responsible for every action of its employees and understands the impact that can be caused if involved in fraudulent acts.

Public Accountant Firm Size and Earnings Management

Based on the data processing results in the table above, this study shows that the audit quality variable has a significance value of 0.683 (> 0.05) H0 is accepted, and H1 is rejected. So it can be said that audit quality does not affect earnings management. Audit quality, which is proxied by the size of KAP, in this study does not affect earnings management. Earnings management practices may occur because the company desires that the company's financial performance must look good in the eyes of potential investors but ignores the existence of Big-4 auditors (Luhgiatno 2010). In addition, the existence of Big-4 auditors is not to reduce earnings management but rather to increase the credibility of financial reports by reducing the disturbances in them so that they can produce more reliable financial reports (Cahyonowati 2006).

Auditor Specialization and Earnings Management

This study shows that the auditor specialization variable has a significance value of 0.043 (<0.05) H0 is rejected, and H1 is accepted. It can be concluded that auditor specialization has a negative effect on earnings management. This study is in line with Becker et al. (1998) explained that the auditor's industry specialization could detect earnings management because the auditor's industry specialization has more knowledge (superior knowledge) about a particular industry. The results of this study are also consistent with the research conducted by Gramling et al. (2001) showed that the use of industry specialization auditors could detect earnings management, prediction errors, and the ability to predict future cash flows. The auditor's industry specialization ability to detect earnings management will encourage clients not to perform earnings management. In addition, industry specialization auditors have a better understanding of industry characteristics, are more compliant with auditing standards, understand risks and problems in the audited industry, have a better error detection ability than non-specialized industry auditors so that industry specialization auditors can better reduce management accrual earnings than non-specialized industry auditors (Januarsi, 2009)

Control Variables and Earnings Management

This study shows that the return on assets variable has a significance value of 0.001 (<0.05) so that H0 is rejected and H1 is accepted. Profitability as a conception of the company's operational performance and the company's ability to generate profits is a component that investors or creditors consider, causing pressure for management to have good profitability in front of investors and creditors. This research aligns

with Ratnasari and Prastiwi (2010), explaining that lower profitability will encourage companies to carry out earnings management.

This study shows that the leverage variable has a significance value of 0.005 (<0.05) so that H0 is rejected and H1 is accepted. This research aligns with Mahiswari and Nugroho (2016), explaining that a high level of liability will make it more difficult for company management to predict its future. The higher the level of liability owned by the company, the tighter the supervision carried out by creditors or investors so that the flexibility of management to carry out earnings management decreases.

4. CONCLUSION

The results of this study indicate that the disclosure of anti-corruption measures can reduce the occurrence of earnings management because anti-corruption disclosure provides information on the strategies undertaken by the company in avoiding fraudulent actions so that stakeholders get an indication that the company is able to take responsibility for every action of its employees and understand the impact that can arise if involved in fraudulent acts. This is supported by the actual presentation of financial statement information by the auditor industry specialization. Industry specialization auditors can detect earnings management because industry specialization auditors have superior knowledge about specific industries. In addition, industry specialization auditors have a better understanding of compliance with auditing standards and understand the risk of fraud, thereby reducing the company's opportunity to perform earnings management.

However, audit quality cannot be concluded to have an influence on earnings management because public accountant firm size does not show a significant effect. This is related to the existence of Big-4 auditors not to reduce earnings management but rather to increase the credibility of financial reports by reducing the disturbances in them so that they can produce more reliable financial reports (Cahyonowati 2006). Meanwhile, the two control variables used have a significant adverse effect on earnings management. This study has several limitations. First, the research object is only focused on mining sector companies during 2015-2019. Meanwhile, in 2015-2019, many companies have not published sustainability reports or disclosed anti-corruption disclosures. The use of a research sample of 55 samples is undoubtedly not enough to describe the effect of anti-corruption disclosure, auditor specialization, whistleblowing system, return on assets, and leverage on earnings management. Further researchers can use different indicators of anti-corruption disclosure as released by Transparency International and use different earnings management measurement models such as Dechow and Dichev (2002) and Kothari *et al.* (2005).

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