

## The Influence of the Independent Board of Commissioners, Audit Committee and Accounting Conservatism on Profit Quality in the Indonesian Banking Industry



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**ABSTRACT:** Earnings quality is an important factor in the banking industry that has a significant impact on the health and sustainability of a company. The purpose of this study was to examine the effect of the Independent Board of Commissioners, Audit Committee, and Accounting Conservatism on Earnings Quality in the Indonesian banking industry. The independent variables used include the Independent Board of Commissioners, Audit Committee, and Accounting Conservatism. The dependent variable is earnings quality as measured by discretionary accruals. The data in this study is secondary data from 17 banks or companies listed on the Indonesia Stock Exchange in 2013-2017. The population for this study were banking companies in Indonesia that were listed on the Indonesia Stock Exchange (IDX) in 2013-2017, selected based on a sampling technique using purposive sampling. Methods of data analysis using multiple linear regression tests. The results of the study show that the independent board of commissioners has a positive effect on earnings quality. Meanwhile, conservatism has a negative effect on earnings quality. Furthermore, the audit committee has no effect on earnings quality.

**KEYWORDS:** Independent Board of Commissioners, Audit Committee, Accounting Conservatism, Earnings Quality

### I. INTRODUCTION

Banking in Indonesia has a very important role in supporting economic growth and national development. As one of the most developed sectors in the Indonesian economy, the banking industry plays a role in collecting funds from the public and providing essential financial services to individuals, businesses and other sectors (Pranyoto & Ovami, 2022). Banks are a business whose aim is to make a profit. Every business entity is required to publish financial reports to see the company's performance as a result of the company's activities. Financial reports are one of the main sources of financial information which is very important for management and stakeholders in making economic decisions (Novitasari et al., 2019). One of the important elements in financial reports used to measure management performance is the profit report. If the company's performance increases, it can be described as being in good condition, which will attract many investors to invest in the company (Nurshofyani et al., 2016).

In Profit formation in financial reports is a form of accountability in measuring the performance of a corporation. The quality of earnings is very important because the quality of earnings information available to the public can show the extent to which earnings can influence decision making and can be used by investors in assessing a company (Azizah, 2022). Earnings quality is used by decision makers or management to make appropriate measurements of the company's current capabilities and can be used as a basis for estimating the company's capabilities in the future (Dempster & Oliver, 2019). According to Dang et al., (2020) that information about profits helps companies to estimate and predict how much performance they can produce in the future, the amount of performance also predicts the ability of company managers to generate profits to be used to provide investor dividends, creditor interest and government taxes.

Earnings quality can be used as an indicator of good or bad performance of a corporation to manage its resources. According to Dechow et al., (2010) there are 3 indications Good earnings quality is, firstly, being able to describe the company's operational results, secondly being able to accurately describe the company's operational capabilities, and thirdly being a measuring tool for assessing the company. Good earnings quality illustrates that investors are interested in earnings information (Ilyas, 2018) and (Tarmidi et al., 2023). As users of financial reports, investors and creditors use profit information and its components to help them calculate corporate capabilities, predict long-term performance, see a picture of future performance, and estimate corporate investment risks and debt to the company.

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Earnings quality is an important factor in the banking industry that has a significant impact on the health and sustainability of the Company (Tarmidi et al., 2023). There are several factors that influence earnings quality, namely corporate governance factors and accounting conservatism. The influence of corporate governance and accounting conservatism on earnings quality in the banking industry in Indonesia is a serious concern because earnings quality is an important indicator of the financial performance of a company, including companies in the banking sector. Corporate governance refers to the practices and policies that govern how a company is managed and supervised, including strategic decision making and risk management. According to research Shiri et al., (2012) that good corporate governance influences earnings quality, where managerial ownership and audit committee influence earnings quality. According to research Wahyudianti et al., (2021), proving that good corporate governance mechanisms such as the board of commissioners and audit committee have no effect on earnings quality.

Apart from corporate governance, accounting conservatism also has a significant role in determining the quality of earnings in the banking industry. Accounting conservatism refers to the tendency to take a conservative approach in reporting financial transactions. In the banking context, accounting conservatism can result in lower revenue recognition or earlier recognition of losses, which in turn can affect earnings quality. The use of accounting conservatism in the banking industry in Indonesia, as determined by applicable accounting principles, is expected to provide more accurate and reliable information to stakeholders. Based on research conducted Zubaidah, (2019) and Asri, (2017), states that accounting conservatism has a positive effect on earnings quality. However, based on research results Cahyani & Khafid, (2020) and Krismiaji & Sururi, (2021) shows that conservatism has no effect on earnings quality.

This is important considering the important role of banks as financial institutions that collect public funds and provide financial services to stakeholders. In the context of the influence of corporate governance and accounting conservatism on earnings quality in the banking industry in Indonesia, research and empirical studies have been conducted to see the relationship between these two factors (Yadiati & Mubarak, 2017). This is important to understand how corporate governance practices and accounting conservatism can affect the quality of profits of banks in Indonesia. This research replicates research Azizah and Khairudin (2022). The research aims to replicate previous research in order to verify the results that have been found and ensure the applicability of these findings in different contexts, especially for the banking industry.

## **II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

### **A. Agency Theory**

Agency theory was originally put forward by Jensen and Meckling in 1976. This theory discusses the business contract relationship between two parties, namely the agent and the principal. They define an agency relationship as a contract between the principal as a shareholder and the agent, who has the authority to run the company and make decisions (Jesen & Mecklin, 1976). Separation of roles in agency relationships often leads to conflict between managers and shareholders. Conflict can occur because humans are economic creatures who have self-interest (Heath, 2011). Even though both parties have the same goal, namely increasing the value of the company, it can be believed that the agent will not always act in accordance with the wishes of the principal and act according to his own will, resulting in an agency conflict.

Agency conflicts result in managers tending to report profits opportunistically in their interests. Opportunistic actions that managers can take are manipulating profits. Manipulation means falsifying or embezzling money or documents. Profit manipulation is one of the acts of fraud in financial reporting because actual information has been falsified. Agents' actions in manipulating financial reports for their personal interests will result in low earnings quality (Dewi & Devie, 2017). One way to improve earnings quality is to reduce earnings management (reducing the opportunistic attitude of managers) and the use of the precautionary principle (accounting conservatism) in reporting financial statements.

### **B. Quality of Earnings**

Earnings quality is defined as the company's ability to convey information about profits that is no different from actual profits (Kumalasari et al, 2022). Companies that have high profit quality provide complete and accurate information that will not mislead users of financial statements. Earnings quality is the ability of earnings to reflect the truth of the company's earnings and predict future earnings by reviewing the stability and persistence of earnings (Bernard & Stober, 1998).

Profit quality is an assessment of the profits obtained by the company on an ongoing basis so that it can reflect the actual situation of the company's finances. Earnings quality is also an indicator of whether the profits obtained by the company are the same as previous plans. Profit with good quality is profit that is useful for decision making with its characteristics in the form of relevance, reliability, comparability or consistency (Kumalasari et al, 2022) and (Pranyoto & Ovami, 2022).

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Earnings quality is the quality of earnings information available to the public which is able to show the extent to which earnings can influence decision making and can be used by investors to assess the company. Quality profits are profits that reflect the company's actual financial performance. The characteristics of quality profits are being able to accurately reflect the company's current operational performance, being able to provide a good indicator of the company's future performance and being a good measure for assessing company performance.

### **C. Corporate Governance**

According to the World Bank, corporate governance is a set of laws, provisions and principles that must be implemented which can increase the results of corporate resources working effectively, producing long-term economic value for the company's owners and the surrounding population as a whole (Kaja & Werker, 2010). Corporate governance is defined as an internal control system in the banking industry which has the main objective of managing significant risks to fulfill its business objectives through monitoring banking industry assets and increasing the value of shareholder investments in the long term (Ho & Shun Wong, 2001). The consistent application of good corporate governance principles in the banking industry attracts the interest of domestic and foreign investors. This is important for industries that are developing their businesses, such as making new investments and expansion projects. To see the implementation of corporate governance by looking at its components such as managerial ownership, institutional ownership, independent board of commissioners, audit committee (Zubaidah, 2019).

### **D. Accounting Conservatism**

Conservatism is one of the principles implemented in accounting. According to Watts (2003) (in Soraya and Harto, 2014). Conservatism is management's action by anticipating more profits and recognizing losses more quickly. According to Wibowo (2002) (in Utama, 2015) conservatism is a principle in financial reports to recognize and measure company assets and profits which is carried out with full prudence (prudent). The implication of implementing conservatism is that profit and asset figures are low while costs and debt are high. The principle of conservatism can limit managers' actions in opportunistic management of profits by taking advantage of their position as parties who have more information (Mayangsari and Wilopo, 2002).

Conservatism is an accounting concept that has pros and cons. Kiryanti and Supriyanto (2006) (in Ulistianingsih, 2017) say that financial reports prepared based on conservative methods will tend to be biased because they do not reflect the actual condition of the company, giving rise to doubts about the benefits of these financial reports. Meanwhile, Fala (2007) (in Wijaya, 2012) states that the application of conservative accounting will produce quality profits because this principle prevents companies from exaggerating profits and helps users of financial reports by presenting profits and assets that are not overstated.

### **E. Hypothesis**

#### **1) Independent Board of Commissioners and Earnings Quality**

The Independent Board of Commissioners is a board of commissioners that is not affiliated with management, other members of the board of commissioners and controlling shareholders, and is free from business or other relationships that could affect its ability to act independently or act in the interests of the company (Shiri et al., 2012). According to Novitasari et al., (2019) states that the composition of the board of commissioners from outside can reduce fraudulent financial reporting and the greater the proportion of the board of independent commissioners, the higher the supervision in the company, making managers more careful in running the company, so that it can improve the quality of profits. So the first hypothesis is that there is an influence of the independent board of commissioners on Earnings Quality.

#### **2) Audit Committee and Earnings Quality**

Decree of the Chairman of BAPEPAM No: Kep-29/PM/2004 concerning the Establishment and Guidelines for Implementing the Work of the Audit Committee, namely that the audit committee is a committee formed by the board of commissioners to carry out the task of supervising company management. Several benefits from forming an audit committee include, first, the audit committee supervises financial reports and carries out external audits. Second, the audit committee carries out independent supervision of company management. Third, the audit committee carries out independent supervision over the good implementation process in influencing the quality of financial reporting which will ultimately affect quality (Azizah, 2022) and (Sae-lim & Jermstittiparsert, 2019). So it can be concluded that the existence of an audit committee is expected to improve management actions in the banking industry to implement Profit Quality in preparing company financial reports (Bilal et al., 2018). The second hypothesis is there is an influence of the audit committee on Earnings Quality.

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## 3) Conservatism and Earnings Quality

According to Watts (2003) Conservatism is management's action by anticipating no profit and recognizing losses more quickly. The increasing use of accounting conservatism causes management to tend to be less aggressive in recognizing profits, so that management practices Earnings Quality with an earnings management pattern. The higher the accounting conservatism, the higher the use of Earnings Quality practices (Asri, 2017). So the third hypothesis is that there is an influence of accounting conservatism on Earnings Quality.

## III. RESEARCH METHODS

### A. Population and Sample

The research population is the banking industry listed on the Indonesia Stock Exchange (BEI) in 2013-2017. Sample selection was based on the purposive sampling method with the following criteria:

- 1) The banking industry from 2013-2017 is listed on the Indonesian Stock Exchange.
- 2) Banking companies whose data is complete and publish annual reports during the data collection period.
- 3) Companies included in the bank category with BUKU 3 and 4.

### B. Research variable

#### 1) Dependent Variable (Dependent Variable)

The dependent variable used in this research is Earnings Quality which will be proxied by discretionary accruals (PM Dechow & Schrand, 2004) and (Bilal et al., 2018). The greater the Discretionary Accruals indicates that the company is implementing earnings management so that the quality of earnings will decrease and vice versa. According to Dechow et al., (1995) Discretionary accruals calculations based on Modified Jones are calculated using the following formula:

a. Calculation of Total Accrual is calculated using the formula:

$$TA_{it} = NI_{it} - CFO_{it}$$

Information :

TA<sub>it</sub> : Total accruals of company i in year t

NI<sub>it</sub> : Net profit of company i in year t

CFO<sub>it</sub> : Cash flow from operating activities of company i in year

b. Non-Discretionary Accrual Calculation is calculated using the formula:

$$NDA_{it} = TA_{it-1}$$

Information :

NDA<sub>it</sub> : Non-discretionary accruals company i in year t

TA<sub>it-1</sub> : Total accrual company i in year t-1

c. Discretionary Accruals calculated using the following formula:

$$DA_{it} = (TA_{it} - NDA_{it}) / A_{it-1}$$

Information :

DA<sub>it</sub> : Discretionary Accruals of company i in year t

TA<sub>it</sub> : Total accruals of company i in year t

A<sub>it-1</sub> : Total assets of company i in year t-1

NDA<sub>it</sub> : Non Discretionary Accruals company i in year t

#### 2) Independent Variable (Free variable)

The Independent Variables in this research consist of:

a. Independent Board of Commissioners

An independent board of commissioners is a board of commissioners that is not affiliated with management. According to government regulations, the composition of independent commissioners is at least 50% of the total number of members of the board of commissioners. A larger board of commissioners will increase supervision of company managers so that the quality of profits will increase. The Independent Board of Commissioners is calculated as follows:

Proportion of independent commissioners ( $X_1$ ) =  $\frac{\text{Independent Commissioner}}{\text{Total board of commissioners}} \times 100\%$

Total board of commissioners

b. Audit Committee

Audit committee based on Kep. 29/PM/2004 is a committee formed by the board of commissioners to carry out the task of supervising the company's accounting management. Membership of the audit committee is regulated in the Decree of the

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Chairman of BAPEPAM No: Kep-643/BL/2012 where the audit committee consists of at least three people including the chairman of the audit committee. The chairman of the audit committee is a registered independent board of commissioners and other committee members come from independent external parties (Hamdan et al., 2013). A larger Audit Committee will increase supervision of company management so that the quality of profits will increase (Bilal et al., 2018). The audit committee is measured:

## Σ Member of the Audit Committee

Conservatism

Watts (2003a) defines conservatism as the principle of prudence in financial reporting that companies do not rush in recognizing and measuring assets and profits, as well as recognizing losses and debts that are likely to occur so that accounting conservatism is management action by anticipating more profits and losses. recognize losses more quickly so that it will improve the quality of the company's profits. Conservatism is measured according to Givoly & Hayn, (2000):

$$CONACC_{it} = (NI_{it} - CFO_{it}) \times -1$$

Information :

CONACC<sub>it</sub> : the level of conservatism of company i at time t

NI<sub>it</sub> : Net income (profit) before extraordinary items plus depreciation and amortization

CFO<sub>it</sub> : Net income (profit) before extraordinary items plus depreciation and amortization

## IV. RESEARCH RESULTS AND DISCUSSION

### A. Classic Assumption Test

#### 1) Normality Test

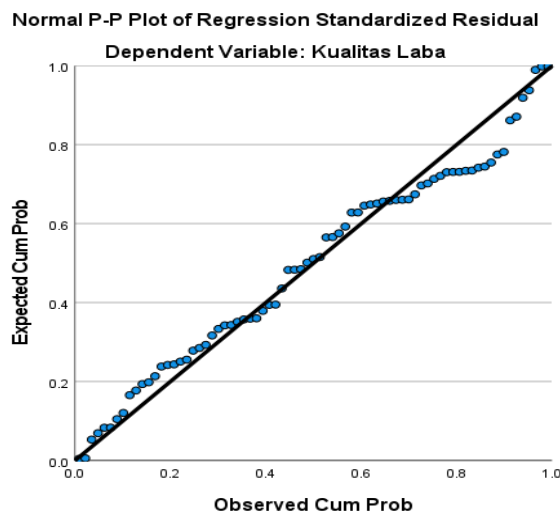


Figure 1. Normality Test Results

Based on Figure 1, it can be explained that the points follow a diagonal line, so it can be said that the data is normally distributed.

#### 2) Multicollinearity Test

Table 1. Hasil Uji Multikolinieritas

Coefficients<sup>a</sup>

Model		Standardized Coefficients		Collinearity Statistics	
		Beta	Sig.	Tolerance	VIF
1	(Constant)		.034		
	Comparison of the Board of Independent Commissioners	.283	.008	.927	1.079
	Audit Committee	-.109	.289	.945	1.059
	Accounting Conservatism	-.521	.000	.967	1.034

a. Dependent Variable: Earnings Quality

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Based on the table above, the Tolerance value for the four variables is  $> 0.10$  and the VIF value is  $< 10$ . This means that there are no symptoms of multicollinearity in the data.

### 3) Heteroscedasticity Test

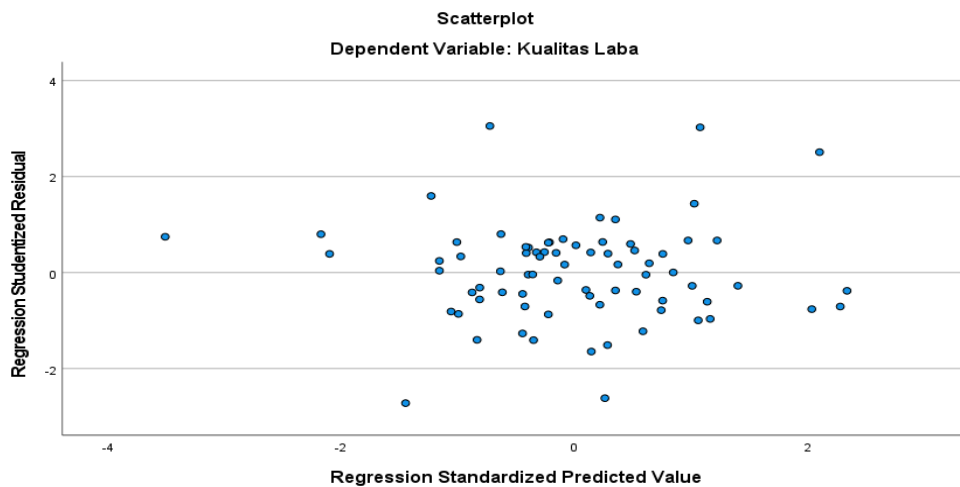


Figure 2. Hasil Uji Heteroskedastisitas

Based on the test results, it was found that the scatterplot graphic display was spread out and did not form a particular pattern, so heteroscedasticity did not occur.

### B. Multiple Linear Regression Test

Based on table 2, the regression equation from this research is:

$$Y = 0.283 X_1 - 0.109 X_2 + 0.027 - 0.521 X_3 + e$$

#### The influence of independent commissioners on earnings quality

Based on the table results, the significance value for the independent board of commissioners is  $0.008 < 0.05$ , so the first hypothesis is accepted, meaning that the independent board of commissioners has a positive influence on the quality of earnings in the banking industry listed on the Indonesia Stock Exchange in 2013-2017. Based on the test results, independent commissioners have a positive effect on earnings quality, meaning that the greater the percentage of the board of commissioners will reduce the quality of the company's earnings. This research is in accordance with research Ahmed et al., (2006) which states that the influence of the independent board of commissioners is increasing but the quality of profits is declining.

#### The influence of the audit committee on earnings quality

Based on the results of the significance value table, the audit committee is  $0.289 > 0.05$  so  $H_2$  is rejected, meaning that the audit committee has a negative and insignificant influence on Profit Quality in the banking industry listed on the Indonesia Stock Exchange in 2013-2017. So the results of testing the second hypothesis found that the audit committee has no effect on earnings quality. The results of this study are consistent with research conducted by Budianto et al., (2018) and (Baxter & Cotter, 2009), where the audit committee has no effect on earnings quality.

#### The Effect of Conservatism on Earnings Quality

Based on the results of the significance value table, Accounting conservatism is  $0.000 < 0.05$  so the third hypothesis is accepted, meaning that conservatism has a negative influence on Profit Quality in the banking industry listed on the Indonesia Stock Exchange in 2013-2017. The results of this study are consistent with research conducted by Watts, (2003) where companies with high conservatism tend to improve earnings quality by reducing overstatements in the company's financial reports.

### C. DISCUSSION

From the research results, corporate governance has a positive effect on earnings quality. This means that the greater the percentage of independent commissioners, the lower the quality of profits. The research results are supported by research (Ujiyanto & Pramuka, 2007) and (Ilham et al., 2022) states that corporate governance has a negative effect on earnings quality.



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Banks are an industry that is very strict with government regulations. So any policy must be in line with government regulations. The placement of an independent board of commissioners in a company is only possible to complete regulatory obligations determined by the government, so that it has no influence on the regulation of company activities and besides that, improving corporate governance usually includes strengthening supervision and internal governance of the company. This could mean increased scrutiny of unethical or illegal business practices, including profit manipulation. With so many rules and controls in place, companies may have to discontinue practices previously used to artificially increase profits. As a result, earnings quality may decline.

The audit committee has no effect on earnings quality. This means that no matter how many audit committees there are, it does not affect the quality of profits produced by the company. The results of this study are consistent with research conducted by (Zabrina & Widiatmoko, 2022), (Baxter & Cotter, 2009) and (Nanang & Tanusdjaja, 2019) where the formation of an audit committee is simply to comply with regulations set by BAPEPAM which require the existence of an audit committee in the company to avoid sanctions. Audit committee members do not actively carry out their duties, resulting in the audit committee's performance not being effective and optimal in monitoring company performance, especially in reviewing the company's financial reports to minimize Earnings Quality practices.

The effect of accounting conservatism on earnings quality is a negative effect, which means that the more conservative the accounting, the more earnings quality will increase. The research results are supported by research Jabbar, (2019) and (Asri, 2017) states that the principle of conservatism is considered an advantage because it can minimize the optimistic nature of management and avoid attitudes that tend to be excessive in financial reports. Accounting conservatism becomes a barrier for management to carry out earnings management so that the quality of earnings increases. Conservatism is a prudent reaction in facing the uncertainty inherent in the company to try to ensure that the uncertainties and risks in the business environment are adequately considered. Accounting translates reporting that produces true value into fundamental qualities of accounting that must meet the characteristics

### V. CONCLUSION

The quality of earnings from financial reports is strongly influenced by the principle of conservatism. Accounting conservatism is considered an advantage because it can minimize management's optimistic nature and avoid attitudes that tend to be excessive in financial reports so that reports are of higher quality. The placement of an independent board of commissioners in a company is possible only to fulfill regulatory obligations determined by the government, so that it has no influence in regulating company activities, including profit manipulation. As a result, the quality of company profits may decline even though supervision is getting tighter.

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