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Role of Corporate Governance as Moderating between Related Party Transactions and Earning Management in State-Owned Enterprises Indonesia

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Abstract:- This study intends to investigate how related party transactions affect earnings management while controlling corporate governance. From 2015 to 2021, 100 BUMN data were used as research samples. This research was conducted using purposive sampling method with SPSS statistical analysis test tool. Based on the results of the study, related party transactions have no effect on earnings management. On the other hand, corporate governance as a moderating variable has also not been able to indicate a strengthening or weakening effect between the relationship between parties' transactions on earnings management..

Keywords:- *Earnings Management; Related Party Transaction;Good Corporate Governance; State-Owned Enterprises.*

I. INTRODUCTION

A. Research Background

In Indonesia, a booming case of earnings management occurred in one of the state-owned enterprises (BUMN), namely PT. Garuda Indonesia (Persero) Tbk. Indications of earnings management are reflected in the financial statements of PT. Garuda Indonesia (Persero) Tbk in 2018. There was one third party company that did not fulfill the obligations of the agreed contract. In that case, PT. Garuda Indonesia (Persero) Tbk company includes a nominal that should not have been recorded. This is certainly detrimental to investors, because the financial information presented does not reflect the actual financial information. Lisboa (2016) suggested that the opportunistic behavior of controlling shareholders and management can harm minority shareholders. Controlling shareholders make transactions with related parties or invest in affiliated companies to maintain their wealth (Suprianto & Setiawan., 2017).

Several studies have found that earnings management practices cause financial losses for minority shareholders (Lisboa, 2016; El-Helaly et al., 2018). In the case of PT. Garuda Indonesia (Persero) Tbk, financial losses were due to uninformative financial statements. Contracts made by PT. Garuda Indonesia (Persero) Tbk and third parties are considered unreliable by some investors. Long-term contracts for 25 years, accruing future earnings to the present, have an impact on earnings that some investors consider unreliable.

OJK Regulation Number 29/POJK.04/2016 PT. Garuda Indonesia (Persero) Tbk was given an administrative sanction. Furthermore, the public accountant (AP) and the auditor of the public accounting firm (KAP) who handled the financial reports of PT. Garuda Indonesia (Persero) Tbk in 2018 were also subject to sanctions by the Ministry of Finance's Center for Professional Development of Finance (PPPK of the Ministry of Finance). The sanctions imposed by the Ministry of Finance and OJK as regulators are intended to improve the quality of the financial system and the financial profession in maintaining public trust. In line with this case, the conclusions of the study related to the importance of corporate governance, regulatory regulations, and the role of the government in company supervision are needed so that the negative impact on earnings management can be minimized. (El-Helaly et al., 2018; Maigoshi, et al, 2016; Suffian et al., 2018).

According to Rankin et al. (2012), earnings management practices are causing concern around the world due to their negative effects on financial reporting and financial markets. Profit, which is an indicator of company performance, is considered important for users of financial statements. This perspective raises the interest of company owners and managers in managing reported earnings, thereby obtaining personal benefits. In general, there are two main methods of managing earnings, namely: manipulating accounting accruals and manipulating real activities to achieve certain targets for reported earnings (Roychowdhury, 2006).

One method that has the potential to achieve the management of reported profit targets is the use of related party transactions. Company owners can abuse these transactions for their own benefit, and try to hide it through the management of reported earnings (Habib et al., 2017). It can be argued that although this problem is a problem in developed countries, it has the potential to be relatively more problematic in developing countries. Corporate governance in developing countries is generally weak, resulting in limited disclosure and transparency in financial reporting (Li et al., 2014).

Previous research on earnings management with related party transaction antecedents showed inconsistent results. El Helaly et al. (2018) stated in their research that there are negative consequences for earnings management practices and related party transactions. This has an impact on a decrease in shareholder wealth, a decrease in the quality of financial reports, and an increase in the number of financial fraud cases. The results of this study are in line with research (Kumaat, 2013; Lisboa, 2016; Maigoshi et al., 2016; Khober & Herusetya, 2017; El Helaly et al., 2018).

Prior studies on earnings management and related party transactions tended to employ manufacturing enterprises as research samples (Kumaat, 2013; Lisboa, 2016; Maigoshi et al., 2016; Khober & Herusetya, 2017; El Helaly et al., 2018).This study will employ a sample of state-owned and non-state-owned enterprises in the same sector category in light of the phenomenon in the case of the state-owned company PT. Garuda Indonesia (Persero) Tbk. Because government entities are subject to different monitoring, regulation, and governance than private businesses, researchers are interested in employing a sample of SOEs.

Good corporate governance cannot completely reduce earnings management practices (Waworuntu & Hokardi, 2012; Liu et al., 2013). Companies that have a governance mechanism may or may not practice earnings management. (Waworuntu & Hokardi, 2012; Kumaat, 2013). On the other hand, there are several research results that show that corporate governance is able to reduce earnings management practices (Abbadi et al., 2016; Sáenz & Garc a-Meca, 2014; Ilyas et al., 2018).

II. LITERATURE REVIEW

A. Theory Agency Type II

Most of the literature on agency theory includes agency conflicts between owners and managers (commonly referred to as Type I agency costs). On the other hand, some literature has developed an opinion covering agency conflicts between majority owners and minority owners (commonly referred to as Type II agency costs). The second type of agency theory is observed in concentrated ownership arrangements in firms, where majority owners supported by the board of directors can benefit from private information and make decisions in their favor, often at the expense of minority owners' interests (Lisboa, 2016).

Alhadab et al. (2020) in their research found that Type II Agency Theory is a consequence of highly concentrated ownership, which gives them strong incentives and the ability to maximize their interests at the expense of minority shareholders. The results of this study are consistent with El-Helaly's research (2018), which concludes that the Type II Agency theory, where majority shareholders use related party transactions with the aim of transferring company profits and wealth to other companies under their control, has a strong incentive to maximize their interests. This has an impact on the interests of minority shareholders, who are sacrificed.

B. Earnings Management

Agency problems between majority shareholders and minority shareholders have an impact on earnings management practices (Nurim et al., 2017). The conflict between the majority shareholder and the minority shareholder, which is the impact of information asymmetry, is caused by the characteristics of a concentrated company, which is a representation of type II agency theory (Alhadab et al., 2020). Asymmetry of information between company owners and managers, or between majority and minority shareholders, can influence earnings management incentives (Lasdi, 2013).

Information asymmetry between majority shareholders and minority shareholders that has an impact on earnings management actions can be carried out through related party transactions (Kumaat, 2013; Lisboa, 2016; Maigoshi et al., 2016; Khober & Herusetya, 2017 ; El Helaly et al., 2018; Alhadab et al., 2020). Earnings management actions through related party transactions can be carried out through transferring company profits and wealth to other companies under their control (El Helaly et al., 2018). Based on the conclusions of research conducted by El Helaly et al. (2018), the assumption of the factors underlying earnings management through related party transactions is the debt covenant hypothesis.

The debt conscientious hypothesis, which is one of the factors that managers use in earnings management, is intended to avoid violating debt agreements with third parties. Companies with concentrated characteristics, with many affiliates and subsidiaries, and with relatively large company sizes, tend to require large funds as well. One way to get funding for companies is to borrow from creditors. Abusive actions of related party transactions with the aim of earnings management can be carried out by transferring the parent's assets to subsidiaries or affiliates so that the funds needed to finance the parent company can be reduced. The impact of borrowing funds for the parent company from creditors can be minimal. Furthermore, the impact of borrowing funds from creditors that can be minimized is expected to be able to reduce the impact of debt covenant violations by the company. Finally, the debt convenant hypothesis can be one of the assumptions of related party transactions for the purpose of earnings management.

C. Related-Party Transactions

The main concern with related party transactions is whether the transaction has a negative impact on the business. Related party transactions attract special interest because the dominant structure of the company is a family business or a business with a concentrated structure where related party transactions are common (Khanna, 2015). A related party transaction of a company is a transaction between a company and persons related to the business, such as subsidiaries, major shareholders, directors, executives, or their relatives (or business organizations controlled by them). Related party transactions have the potential to be problematic because they can lead to value-destroying transactions such as tunneling and squeeze-out (Khanna, 2015). Furthermore, related party transactions are seen as detrimental when viewed from the perspective of the conflict of interest hypothesis, which is a reflection of agency theory (Gordon and Henry, 2011). However, not all related-party transactions are bad. Some related party transactions can increase the value of the company. Related party transactions can increase the value of the company when they represent the best possible agreement. For example, a director of a company can run his own business that has related party transactions by minimizing the company's transfer costs.

According to Gordon and Henry (2011), related-party transactions are healthy business exchanges that meet the company's economic needs. The efficient transaction hypothesis is the basis for the idea that related party transactions are able to meet the economic needs of the company. In research in developing countries, related party transactions can help reduce the risk of bankruptcy faced by some group companies and can help increase capital (Yendrawati & Sokarina, 2014). On the other hand, related party transactions are economically dangerous for companies based on the agency-principle conflict theory by Khober and Herusetya (2017). Company resources can potentially be expropriated and can cause significant differences in shareholder wealth triggered by conflicts of interest contaminated by related party transactions.

D. Corporate Governance

In public companies, minority shareholders, who have few votes, need a transparent system to protect their rights. Investors who rely on public sources of information to understand companies need to ensure the quality, accuracy, and clarity of financial information. Based on this, transparency in the corporate governance system is needed. This transparency increases investor confidence in making investment decisions. Overall, corporate governance provides direction to companies to create value for shareholders and society in a competitive market (Thanh et al., 2020).

Corporate Governance in Development (2003), published by the OECD Development Center, highlights issues of corporate governance that have not been adequately considered in developing countries. This is based on the financial crisis in East Asian countries in 1997–1998. In Southeast Asian countries such as Malaysia, the Philippines, Indonesia, and Thailand, poor investment structures, weak legal and accounting systems, and incorrect financial practices have contributed substantially to the economic downturn during the crisis (Ho, 2005). This pressure triggered the desire to implement new policies to strengthen corporate governance conditions, restore the economy, and prevent external shocks from turning into major crises (Ho 2005).

Previous literature reveals that corporate governance has an important role in controlling and avoiding earnings management practices related to related party transactions. Alhadab et al., (2020) reveals that related party transactions are often used as a way to carry out earnings management by manipulating transfer prices for various purposes, such as shifting income, avoiding tax burdens, and others, so that the role of corporate governance is needed to control the form of earnings management in transactions. related parties. In line with the results of previous studies, research (Sáenz & Garc a-Meca, 2014; Abbadi et al., 2016; Ilyas et al., 2018) found that the application of corporate governance was able to reduce the possibility of earnings management. Kumaat's research (2013) also links earnings management with corporate governance by introducing a tunneling perspective. This study finds that earnings management is strongly associated with tunneling in the context of weak corporate governance. This study found that companies with higher governance will result in lower levels of earnings management.

The role of corporate governance is also able to influence the actions of adverse related party transactions such as exporting. Lisboa (2016) states that the independence of commissioners and directors can be associated with the occurrence of low related party transactions. Furthermore, Ilyas et al. (2018) concluded that the role of the board's independence is able to prevent related party transactions and help discipline the transparency of these transactions if they occur.

E. Research Framework

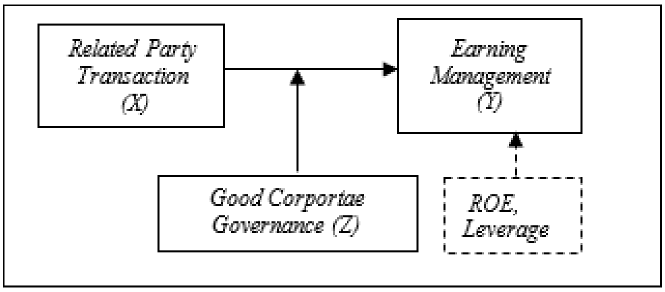

Fig 1:- Research Framework

F. Hypothesis

Based on the preceding framework, the initial hypothesis is as follows:

According to agency theory, there are agency conflicts between majority shareholders and minority shareholders as well as agency conflicts between owners and managers (often referred to as Type I agency costs) (commonly referred to as agency costs Type II). The Type II agency hypothesis, which refers to a corporation with concentrated features, provides an explanation for the company's issues with the main shareholder and minority shareholder.

In the Asian region, where there are many large listed firms with business groups, companies with concentrated characteristics are particularly common. The founder or the family acts as the controlling shareholder in the Asian region, which includes Indonesia, and ownership is typically concentrated in their hands. The issue of controlling shareholders appropriating non-controlling shareholders' money is an example of an agency problem (Utama and Sidharta, 2014).

There is currently a dearth of research in Indonesia on the connection between related party transactions and earnings management. According to earlier research on related party transactions and earnings management actions conducted in Indonesia by Yendrawati and Sokarina (2014), related party transactions did not significantly and adversely affect earnings management actions. Earnings management is typically done to boost or lower the company's profit on the financial statements of the company.

On the other hand, research conducted by Khober & Herusetya (2017) concludes that related party transactions have a significant effect on earnings management. There are negative consequences on earnings management practices and related party transactions. The negative consequences of the relationship between earnings management and related party transactions have an impact on decreasing shareholder wealth, decreasing the quality of financial reports, and increasing the number of financial fraud (Lisboa, 2016; Khober & Herusetya, 2017; El Helaly et al., 2018). The conclusion of previous research implies that related party transactions can be abusive which is a reflection of the conflict of interest hypothesis.

In Indonesia, one case of earnings management and related party transactions is found in one of the company's financial statements, namely the financial statements of PT. Garuda Indonesia (Persero) Tbk in 2018. In this case there were several minority shareholders who felt aggrieved because of the financial statements of the company PT. Garuda Indonesia does not reflect the actual state of the company. Reflecting on this case implies that the relationship of related party transactions and abusive has negative consequences on the decline in the quality of financial statements. Based on this statement, the following hypothesis can be concluded:
H1: Related Party Transactions have a positive effect on Earnings Management.

Kohlbeck & Mayhew (2010) explained that related party transactions can be categorized as harmful (abusive related party transactions) or profitable (efficient related party transactions). In line with this research, research (Utama, 2015) states that there are two contradictory theories regarding related party transactions, namely "the efficient transaction hypothesis" and "the conflict of interest hypothesis."Related party transactions are said to be efficient when they are able to reduce transaction costs.

Related party transactions are transactions carried out by companies with related parties, namely transactions carried out with parties such as associate companies, companies under one control, individual companies, close family companies or companies that have significant voting rights (Alhadab et al.., 2020).

Referring to the conflict of interest hypothesis, related party transactions can be detrimental to the company, especially for minority shareholders. The actions of detrimental related party transactions have the potential to be problematic because they can lead to value-destroying transactions such as tunneling and squeeze-outs (Khanna, 2015). Khober & Herusetya (2017) explain that related party transactions are economically dangerous for companies. Company resources can potentially be expropriated and can cause significant differences in shareholder wealth triggered by conflicts of interest contaminated by related party transactions.

Furthermore, good corporate governance will help companies improve their ability to access various sources of capital, so that they can operate more efficiently (Waworuntu and Hokardi, 2012). Corporate governance is intended to protect the rights of stakeholders and related people (Thanh et al., 2020). Based on this opinion, when the rights of stakeholders are protected, transactions that are detrimental to minority shareholders can be minimized. Finally, good corporate governance is able to weaken the relationship between the number of related party transactions and earnings management (Abbadi et al., 2016; Sáenz & Garcı´a-Meca, 2013; Ilyas et al., 2018). Based on this statement, the following hypotheses can be concluded:
H2: Corporate governance weakens the positive effect

III. RESEARCH METHODS

A. Population and Sample

This study uses quantitative methods. BUMN firms listed on the IDX from 2015 to 2021 make up the population used in this analysis. The choice of BUMN firms listed on the Indonesia Stock Exchange is made for this reason: BUMN companies are expected to have tougher controls and oversight, and as a result, they should be better equipped to represent their state with good governance.

B. Variable Operational Definitions

A variable's operational definition describes how variables are measured and calculated. Following is an explanation of each variable's operational definition:

Variable	Indicator
Earning Management (Y)	Modified Jones Model (Jones, 1991)
Related Party Transaction (X)	The measurement uses a dummy variable. Value 1 = related party transactions / Total Assets > 1%. Value 0 = related party transactions / Total Assets < 1% (Ryngaert & Thomas, 2012).
Good Corporate Governance (Z)	Measurement using the ASEAN corporate governance scorecard index
Return on Equity (C1)	Earning After Tax/Total Asset
Leverage (C2)	DER=(Total Liabilities)/(Total Equity) x 100%

Table 1:- Variable Operational Definitions

C. Data Analysis Method

The following data analysis techniques were used in this study: the classical assumption test, multiple regression analysis, and moderated regression analysis. The equation model used in this study is as follows:

$$EM = \alpha + \beta 1RPT + \beta 2ROE + \beta 3LEV + e \qquad (1)$$

$$EM = \alpha + \beta 1RPT + \beta 2ROE + \beta 3LEV + \beta 4GCG + \beta 5RPT{*}GCG + e \qquad (2)$$

Description:
EM = Discretional accrual
α = Constant
β1- β5 = Regression coefficient of each independent variable
RPT = Related Party Transaction
ROE = Return on Equity
LEV = Leverage
GCG = Good Corporate Governance
e = error

IV. RESULT AND DISCUSSION

Sample of all Indonesian state-owned businesses that are listed on the IDX is used in this study. Total of 112 data were sampled via purposive sampling, and 12 outliers were used to account for abnormalities. The outcomes of the multiple regression analysis and the moderated regression test are as follows:

A. Descriptive Statistics Results

	N	Min.	Max.	Mean	Std. Deviasi
EM(Y)	100	-0.24	0.23	-0.0192	0.1065
RPT(X)	100	0	1	0.7822	0.4148
ROE(C1)	100	-0.23	0.42	0.1102	0.1228
LEV(C2)	100	0.07	0.89	0.5607	0.1808
GCG(Z)	100	0.79	0.95	0.8801	0.0393

Table 2:- Descriptive Statistics Results

Based on the results of the descriptive analysis in the table above, the conclusions that can be drawn are as follows:

- The results of the descriptive analysis of the earning management variable are known to have an average value of -0.0192, with a minimum value of -0.24, and a maximum value of 0.23, and with a standard deviation of 0.1065,
- The results of the descriptive analysis of the RPT variable have an average value of 0.7822 with a minimum value of 0 and a maximum value of 1 with a standard deviation of 0.4148.
- The results of the descriptive analysis of the firm ROE variable have an average value of 0.1228 with a minimum value of -0.23 and a maximum value of 0.42, while the standard deviation is 0.12286,
- Based on the descriptive analysis of leverage variable, the average value is 0.5607 with a minimum value of 0.07and a maximum value of 0.89, while the standard deviation is 0.1808.
- Then the results of the descriptive analysis of the Good Corporate Governance variable have an average value of 0.8801with a minimum value of 0.79 and a maximum value of 0.95, while the standard deviation is 0.0393.

B. Classical Assumption Test

➢ *Autocorrelation Test*

MODEL 1

R	R Square	Adj. R Square	Durbin-Watson
.293a	.086	.057	.10293

Table 3:- Autocorrelation Test Result

MODEL 2

R	R Square	Adj. R Square	Durbin-Watson
.387a	.150	.104	.10032

Table 4:- Autocorrelation Test Result

This study's autocorrelation test employs the Durbin-Watson test, with autocorrelation-free test conditions if the dU < DW < 4-dU. (Ghozali, 2018:111). Based on the table above, autocorrelation does not exist in the data in research models 1 and 2.

➢ *F Test*

MODEL 1 AND MODEL 2		
	Model 1	Model 2
F	3.001	3.307
Sig.	.034	.009

Table 5:- F Test Result

The estimated F value and significance level, as shown in the table above, indicate that 0.05 is significant. Thus, it can be assumed that models 1 and 2 of multiple regression are applicable and that the independent variables influence the dependent variable simultaneously.

➢ *Normality Test*

	One-Sample KS Test	
	Model 1	Model 2
Asymp. Sig. (2-tailed)	.200	.200

Table 6:- Normality Test Results

The The normality test is used to determine if the distribution of data in a group of data or variables is normally distributed or not. This study use One-Sample Kolmorgrov Smornov test, which states that a result have significant > 0.05 that's mean have normal distribution.

➢ *Multicolinearity Test*

MODEL 1

Model	Tolerance	VIF
(Constant)		
RPT	.884	1.131
LEV	.993	1.007
ROE	.880	1.136

Table 7:- Multicoliniearity Test Results

On the basis of the above table, it can be inferred that all independent variables passed the multicollinearity test, as evidenced by VIF values greater than 1 and fewer than 10.

➢ *Heteroscedasticity Test*

MODEL 1

t	Sig.
RPT	0.862
LEV	0.874
ROE	.444

Table 8:- Heteroscedasticity Test Results

MODEL 2

t	Sig.
RPT	0.503
LEV	0.503
ROE	0.205
GCG	0.931
RPT*GCG	0.429

Table 9:- Heteroscedasticity Test Results

Based on the above table of Spearman's rho test findings, it can be inferred that there is no heteroscedasticity problem in this regression model because the significance level of the independent variables is greater than 0.05.

C. Hypothesis Testing

MODEL 1

Variable	B	T_{count}	Sig.
RPT	-.024	-.903	.369
LEV	.171	2.884	.005
ROE	.068	.760	.449

Table 10:- Hypothesis Testing Results

MODEL 2

Variable	B	T_{count}	Sig.
RPT	.850	1.573	.119
LEV	.179	3.082	.003
ROE	.049	.553	.582
GCG	1.308	2.428	.017
RPT*GCG	-.989	-1.613	.110

Table 11:- Hypothesis Testing Results

- Effect of Related Party Transaction on Earning Management

According to the findings of the hypothesis test, related party transactions have no impact on the management of earnings. The findings of this study suggest that related party transactions may be profitable, which is consistent with the efficient transaction hypothesis notion. According to the efficient transaction hypothesis theory, dealings between related parties are economically sensible.

Gordon & Henry (2011), who discovered that related party transactions are healthy business exchanges that satisfy the company's financial demands, support the findings of this study. Related party transactions have been shown in studies conducted in developing nations to assist lower the risk of insolvency experienced by some group companies and to help raise capital (Yendrawati & Sokarina, 2014). The effective utilization of corporate resources is impacted by the low transaction costs faced by the organization. Additionally, the corporation can benefit from the decreased transaction costs by increasing profit income. Finally, a rise in profits will result in a reduction in the firm's earnings management initiatives.

- Effect of Corporate Governance as Moderating between Related Party Transactions on Earnings Management

The results of hypothesis testing indicate that corporate governance has no significant effect on the relationship between related party transactions and earnings management. Based on the results of this study, it can be interpreted that corporate governance has not been able to strengthen or weaken the influence of the relationship between related party transactions and earnings management. The results of this study are in line with research conducted by Waworuntu & Hokardi (2012) and Liu et al. (2013). The results of this study reveal that the ability of good corporate governance practices to reduce earnings management practices is not entirely accurate.

Ineffective corporate governance can be caused by the business environment in Indonesia. This is corroborated by the opinion of Daniel (2003), which states that the business environment in Indonesia is relationship-based (guanxi), which means that commercial activities are dominated by Chinese and overseas Chinese families. Relationship-based business environments (guanxi) are associated with highly personal networks, cronyism, highly concentrated family ownership and special relationships between family businesses and political power (Daniel, 2003; Dieleman and Sachs, 2006). In another study, Rosser (2005) revealed that ineffective governance could be because politicians, bureaucrats, and families tend to block or subvert corporate governance. This is because if corporate governance is effective, it will have an impact on the exposure of special relationships between families and politicians-bureaucrats.

V. CONCLUSION

A. Conclusion

Based on the data processing in this study, several findings were produced. First, related party transactions have no effect on earnings management. This indicates that the practice of related party transactions is an implication of the efficient transaction hypothesis theory, which is profitable. Related party transactions are an economical and rational action. The low transaction costs borne by the company have an impact on the efficient use of company resources. Furthermore, the low transaction costs are able to benefit the company so that it can increase profit income. Finally, an increase in earnings will reduce the company's earnings management actions.

Second, corporate governance as a moderating variable has no effect on the relationship between related party transactions and earnings management. The effect of corporate governance being able to strengthen or weaken the relationship between related party transactions and earnings management in this study was not proven to be significant. Based on the results of this study, the role of corporate governance in public companies in Indonesia has not been fully effective. Ineffective corporate governance can be caused by the business environment in Indonesia. Indonesia's business environment, which tends to be concentrated and where there is a special relationship between business people and politicians, is indicated to be one of the causes of ineffective corporate governance. Another indication of the ineffectiveness of corporate governance in Indonesia is the regulations and standards of corporate governance that are getting better, but not matched by the implementation of these regulations and standards.

B. Suggestion

- One of the efforts that can be made by regulators is to provide better supervision and require the measurement of the effectiveness of the role of governance in accordance with the characteristics of companies in Indonesia. It is hoped that with the increasing effectiveness of the role of corporate governance, the quality of the financial system will improve.
- On the other hand, investors who obtain financial information through financial statements should be more careful in investing their funds, especially in companies with concentrated company characteristics. This is because companies with concentrated characteristics are able to carry out negative related party transactions. Investors should analyze more deeply the company that investors are aiming for so as not to potentially cause losses for investors., especially in companies with concentrated company characteristics. This is because companies with concentrated characteristics are able to carry out negative related party transactions. Investors should analyze more deeply the company that investors are aiming for so as not to potentially cause losses for investors.

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