The Factors Influencing Earnings Management and Implications for the Cost of Equity Capital

Andry Priharta\textsuperscript{a}, Dewi Puji Rahayu\textsuperscript{b}, Eri Marlapa\textsuperscript{c}, Endri Endri\textsuperscript{d},
\textsuperscript{a,b}Universitas Muhammadiyah Jakarta, Indonesia, \textsuperscript{c,d}Universitas Mercu Buana, Jakarta, Indonesia, Email: \textsuperscript{a}andry.priharta@umj.ac.id, \textsuperscript{b}dewipujirahayu@umj.ac.id, \textsuperscript{c}eri.marlapa@mercubuana.ac.id, \textsuperscript{d}endri@mercubuana.ac.id

This study aims to analyse the CGPI, audit committee, and company size on earnings management and their implications for the cost of equity capital. The research method used is panel data regression analysis, with a purposive sampling method obtained a sample of eight companies that consistently followed the Corporate Governance Perception Index (CGPI) program respectively from 2012-2016 and listed on the Indonesia Stock Exchange. The results of the research showed that in the first model partially CGPI, and the audit committee did not affect earnings management. In contrast, the size of the firm had a significant positive effect on earnings management. Furthermore, in the second model, CGPI and earnings management partially had a significant positive effect on the cost of equity capital. The audit committee did not affect the cost of equity capital, and the size of the company had a significant negative effect on the cost of equity capital. Earnings management is still quite high, and the existence of CGPI and audit committees is still less effective to oversee the actions of the earnings management. Therefore, investors need to anticipate the accrual information which is presented in financial statements because of the higher the accrual level, then the higher the cost of equity capital.

Keywords: CGPI, audit committee, firm size, earning management, cost of equity capital
Introduction

Some researches show that there are some influences on earnings management, such as corporate governance and the size of the company. Priharta et al. (2018) said that the occurrence of earnings management practices was certainly a question of many parties, related to corporate governance. Related to the implementation of corporate governance in Indonesia, there is an institution called the Indonesian Institute for Corporate Governance (IICG) as an independent institution that conducts dissemination and development of corporate governance. Since 2001, this institution has carried out a ranking program known as the Corporate Governance Perception Index (CGPI) which is a research program and ranking of the application of good corporate governance to determine the extent of companies in Indonesia to apply the principles of good governance. The companies which participate in this program is voluntary.

The other proxy used for corporate governance is the audit committee. The audit committee is one component of corporate governance that has an essential role in monitoring management activities and independent auditors in the financial reporting process. Lin et al. (2006) said that the audit board members who had educational backgrounds in finance, the oversight of the audit committee of management are more effective. However, according to Badolato et al. (2014), the existence of an audit committee was not enough to prevent the company from financial cases, especially the cases which were related to earnings management. The audit committee also requires independence and effective in monitoring the financial reporting process. Therefore, this regulation is reaffirmed by the issuance of BAP-EPAM's regulation No.: Kep 29/PM/2004 on September 24, 2004. The regulation requires companies listed on the JSX to have an audit committee.

Furthermore, besides corporate governance that affects earnings management is the size of the company. The size of the company will be significant for investors and creditors because it will be related to the risk of investments. Medium and large companies have more pressure from the stakeholders so that the company's performance is in line with the expectations of their investors compared to the small companies (Siregar & Utama, 2008). According to Waweru et al. (2011), large companies more likely choosing the accounting methods to reduce reported profits compared to small companies because they have high political costs.

The practice of earnings management that occurs in companies has some impacts. One of those impacts is the cost of equity capital. Earnings management which is conducted by managers makes fractional information on the financial statement. Whereas, according to Chang and Sun (2015), information about the company is essential to be used as a basis for consideration in decision making, in this case, to make investments or credit to the company. One form of information needed by decision-makers, especially for investors and creditors is
the company's financial statements. Financial statements are the central part of reporting that can be used as an important tool to communicate the information to parties which have interests in the company, both internal and external parties. In addition, the cases of delayed reports also frequently occur; this indicates that there is a problem in the issuer's financial statements so that it requires quite a long time to be solved.

According to Siagian and Tresnaningsih (2011), there was empirical evidence which stated that the level of issuer's earnings management in Indonesia is relatively high. The level of protection against investors tends to be low, creating the question of whether investors consider the accrual amount (a proxy for earnings management) in determining the required stock return (required rate of return). The required return on the stock is the rate of return desired by investors to invest their money in the company and is known as the cost of equity capital.

This study tries to test CGPI, audit committees, and firm size for earnings management and their implications for the cost of equity capital. Some research results still found the inconsistency in these factors affecting earnings management and having an impact on the cost of equity capital. The results of this study are expected to be able to provide information to investors to anticipate more about management actions in conducting earnings management. Thus, the formulations of the problem in this study include are there any CGPI, the audit committee, company size, and earnings management on the cost of equity capital?

**Literature Review**

*Positive Accounting Theory*

Watts and Zimmerman (1986) revealed an accounting theory that explained about economic factors or characteristics of a particular business unit could be associated with managerial behaviour, which more specifically revealed the influence of economic variables on manager's motivation in choosing an accounting method. The presumption of earnings management appears and is done because managers expect a benefit from the actions taken in the reconstruction of the profits. Three hypotheses are underlying the occurrence of earnings management, i.e., 1) Bonus Plan Hypothesis; 2) Debt Covenant Hypothesis; and 3) Political Cost Hypothesis.

*Agency Theory*

Agency relationships appear when one or more individuals (principals) employ other individuals (agents) to provide a service and then delegate the power to the agent to decide on behalf of the principal (Jensen & Meckling, 1976). The perspective of Agency theory is used as the basis to understand the issue of Corporate Governance and Earnings Management.
With financial reports reported by the agent as their performance responsibility, the principal can assess, measure, and monitor the extent of how the agent works to improve his welfare and also as a basis for giving compensation to the agent (Xie et al. 2013).

**Signalling Theory**

The company managements have better information and need to convey it to the investors so that the value of the company's shares could increase. Managers have better information from investors about the value of the company and the prospects of the company in the future, has exposed the investors to the high uncertainty about their investments. That kind of asymmetric information encourages managers to communicate with the expectation that the investors will respond to the information as a signal of certain events that can affect the value of the company. Therefore, signalling theory explains that the managers try to notify to reduce the asymmetric information (Endri et al., 2019).

**Hypothesis Development**

**The Effect of CGPI on Earnings Management**

In addition to being caused by opportunistic management actions, earnings management often occurs due to the poor supervision or monitoring from the company, so it provides an opportunity for agents to take fraudulent actions. The application of good corporate governance will encourage the realisation of transparency in financial recording and reporting and also observing effectively and efficiently. With the existence of transparency, the owner can watch over the performance of his management so that he can suppress the practice of earnings management (Mahrani & Soewarno, 2018). The result of the research from Wuryanti (2013), Priharta et al. (2018) stated that CGPI had a negative influence on earnings management. The meaning is that the companies which implement good corporate governance and have high CGPI scores can minimise earnings management actions that carried out by managers.

**H1:** CGPI has a negative effect on earnings management

**The Effect of the Audit Committee on Earnings Management**

Audit committees which formed within the company are important to minimise manager's behaviour in making earnings management, as well as reducing the occurrence of conflicts of interest and ensuring the achievement of company goals (Xie et al., 2003). The same explanation is stated by Chen et al. (2008), that the existence of an audit committee is also to help agency problems, by reducing asymmetric information between the managers and the board of directors. The results of the study of Kosasih, Siagian and Siregar (2018), Alves
(2013) stated that audit committees negatively affect earnings management. This means that the existence of an audit committee is quite helpful to watch over the reliability of the company's accounting, auditing processes, and especially the interests of shareholders.

**H2:** The Audit Committee has a negative effect on earnings management

**The Effect of Company Size on Earnings Management**

Company size can be interpreted as an effort to assess the size or size of a company. One of the hypotheses of Positive Accounting Theory (Watts & Zimmerman, 1986) that is the political cost hypothesis states that large companies that have high political costs are more likely to choose accounting methods to reduce reported earnings compared to the small companies. It is inversely proportional to the statement of Poli (2013) who consider that the size of small companies more likely to practice earnings management than the large companies. This is because small companies tend to show the condition of the company that always performs well so that investors will invest in that company. Large companies are more concerned by the society so that they have to be more careful in conducting financial reporting so that it impacts the company to report its condition more accurately. The results of several studies, such as Asih (2014), Nalarreason et al. (2019) stated that firm size has a positive influence on earnings management. This means that the larger the size of the company, the indication the manager in making earnings management is higher.

**H3:** Company size has a positive effect on earnings management

**The Effect of CGPI on Equity Capital Costs**

The investors will be interested in investing their capital in companies which have good performance. One of the factors that can achieve good corporate performance is the existence of good governance within the company. The companies that have high CGPI scores mean that those companies are well managed and indicate good performance. This is certainly able to give trust to investors to invest their capital. The companies that have good governance will encourage transparency in financial reporting and conduct monitoring effectively and efficiently. Armstrong et al. (2010) said that financial statements were used as a channel of information that was beneficial to companies and capital owners. Investors tend to prefer companies that publish their financial statements to minimise risk. Therefore, managers must be able to present the company's financial statements in order to attract investors. If the company's performance is good, then the investors can have trust in the company to get a high return on their investment. A high level of a return causes a risk for investment or low cost of equity capital. Meini and Siregar (2014) stated that Corporate Governance Index had proved to have a significant negative effect on the cost of equity.
H4: CGPI has a negative effect on the cost of equity capital

The Effect of the Audit Committee on the Cost of Equity Capital

According to Weir et al. (2002), corporate governance mechanisms could be divided into two, internal and external mechanisms. The internal corporate governance mechanism includes the board of commissioners assisted by the audit committee. On the other hand, external mechanisms can be played by external auditors who carry out assurance on the company's financial statements. Fung (2014) explains that the existence of an audit committee within the company is useful to ensure transparency, the openness of financial statements, fairness for all stakeholders, and disclosure of all information that has been carried out by management even though there are conflicts of interest. The audit committee and independent commissioners are the parties that carry out supervision and control to create fairness, transparency, accountability, and responsibility. These four factors make financial reports more qualified. So, it can be said that the mechanism of corporate governance besides being able to improve the quality of earnings, it is thought that it can also reduce the cost of corporate equity. The results of the study by Abbott et al. (2004), Khemakhem and Naciri (2015) stated that audit committees affected the cost of equity capital.

H5: The Audit Committee has a negative effect on the cost of equity capital

The Effect of Company Size on Equity Capital Costs

Company size can be a proportion of the availability of information in the capital market. Large companies usually have diverse business units, and their business activities are quite large, so the costs incurred by the company will be greater to provide information to the public (investors) so that it will have an impact on the cost of equity capital. Based on the results of research from Embong et al. (2012), Fahdiansyah (2016), Winata et al., (2020) stated that the size of the company had a positive effect on the cost of equity capital.

H6: Company size has a positive effect on the cost of equity capital

The Effect of Earnings Management on the Cost of Equity Capital

Earnings management is an effort by company managers to influence the information in financial statements to understand investors' performance and financial conditions (Sulistyanto, 2008). Brahmana et al. (2018) stated that earnings management caused a lot of information that must be disclosed by the company so that the impact would increase the costs for companies to provide information to the public, where the cost of equity capital is
the rate of return expected by investors and creditors. The results of research by Dewi and Jeffry (2016), Francis et al. (2008) stated that earnings management had a positive effect on the cost of equity capital. So, it can be said that the higher the manager indicated to do earnings management, the higher the level of risk of return on shares and the impact on investors to increase the cost of equity capital.

H7: Earnings management has a positive effect on the cost of equity capital

Methodology

Data and sample selection

The population used in this study are companies listed on the Indonesia Stock Exchange (IDX) and the Corporate Governance Perception Index (CGPI). The sampling technique used was purposive sampling which used criteria as sample members. These criteria include: 1) publicly listed companies listed on the IDX and CGPI during the period 2012-2016 for a row; 2) companies which published audited annual reports for the period 2012-2016; and 3) companies that have data in research. Based on these criteria obtained a sample of eight companies and observation time for five years, with the result that the amount of data observed was 40 observations.

Operationalisation of research variables

1. Corporate Governance Perception Index (CGPI)
   The results of the CGPI program ranking had used the assessment norms based on the range of scores with categorisation as follows: Trustworthy Enough between 55-69.99; Trusted between 70-84.99; and Very Reliable between 85-100.

2. Audit Committee
   The audit committee is measured through a comparison between the number of audit committees originating from independent commissioners and the total number of audit committees in percentage.

   Audit committee =
   \[
   \frac{\text{The number of audit committees from independent commissioners}}{\text{The number of all audit committees}} \times 100\%
   \]

3. Company Size
   To measure company size, the proxy used in this study is the total assets of the company that are natural logarithms.

   \[
   \text{LnSize} = \ln(\text{total asset})
   \]
4. Earnings Management
The calculation of earnings management in this study is proxied based on the ratio of accruals of working capital to sales. Working capital accrual data can be obtained directly from the cash flow statement of operating activities so that investors can directly obtain the data without performing complicated calculations.

\[
\text{Earnings management} = \frac{\text{Accrual working capital (t)}}{\text{Sales period (t)}}
\]

Accrual working capital = \(\Delta CA - \Delta CL - \Delta \text{Cash}\)

Keterangan:

\(\Delta CA\): Changes in current assets in period t
\(\Delta CL\): Changes in current liability in period t
\(\Delta \text{Cash}\): Cash changes and cash equivalents in period t

5. Cost of equity capital
In this study, the cost of equity capital is calculated based on the discount rate used by investors to evaluate the future cash flow used.

\[
r = \frac{B_t + X_{t+1} - P_t}{P_t}
\]

Keterangan:

\(r\): Cost of Equity Capital
\(B_t\): book value per share in period t
\(P_t\): Stock Price for year t
\(X_{t+1}\): profit per share until at the period t + 1

To estimate earnings per share in period t + 1, the Random Walk model is used as follows:

\[
E(X_{t+1}) = X_t + \delta
\]

Keterangan:

\(E(x_{t+1})\) : Estimated earnings per share in period t + 1
\(X_t\): Actual earnings per share in period t
\(\delta\): Drift term which is the average change in earnings per shares for 5 years

Data Analysis Technique

The approach used in this study is panel data. Endri (2010) explained that panel data is a combination of data that has time series and cross-section properties so that it consists of several objects and covers several periods. Before using the regression model in this study,
the assumption of heteroskedastistas will be tested. The final impact is that statistical conclusions for testing hypotheses become invalid. Furthermore, to estimate panel data regression, there are three models, they are common effect, fixed effect, and random effect. In determining the right model, a paired test approach for each model will be carried out using the Chow Test, Lagrange Multiplier Test and Hausman Test. There are two models in this study. The first model is to estimate and analyse the influence of CGPI, Audit Committee and Company Size on Earnings Management. Then the second model is to estimate and analyse the influence of CGPI, Audit Committee, Company Size, and Earnings Management on Equity Capital Costs.

Empirical Results and Discussion

Research results

Model 1: Descriptive analysis is used to explain descriptively the variables used in the study. For the first model, descriptive data can be seen in Table 1 below.

<table>
<thead>
<tr>
<th>Table 1: Descriptive statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>MALA?</td>
</tr>
<tr>
<td>Mean</td>
</tr>
<tr>
<td>Median</td>
</tr>
<tr>
<td>Maximum</td>
</tr>
<tr>
<td>Minimum</td>
</tr>
<tr>
<td>Std. Dev.</td>
</tr>
<tr>
<td>Observations</td>
</tr>
<tr>
<td>Cross sections</td>
</tr>
</tbody>
</table>

Source: Data processed (2019)

Based on table 1, it is known that CGPI has an average value of 0.86975 with a standard deviation of 0.032304. The audit committee found an average value of 0.347 with a standard deviation of 0.118478. Firm size has an average value of 7.939, with a standard deviation of 0.7677887. Earnings management has an average value of 0.300903 with a standard deviation of 0.366049. For the estimation of panel data regression in this study, there are three models, namely common effect, fixed effect, and random effect where paired testing is done for each model to determine the right model. The following below table 2 results of the paired test.
Table 2: Testing the Earnings Management Panel Data Regression Model as Dependent Variables

<table>
<thead>
<tr>
<th>No</th>
<th>Method</th>
<th>Testing</th>
<th>Result</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Chow Test</td>
<td>Common Effect vs Fixed Effect</td>
<td>Prob. Cross-section Chi-square &gt; alpha, that is 0.7179 &gt; 0.05</td>
<td>Common Effect</td>
</tr>
<tr>
<td>2</td>
<td>Langrange Multiplier</td>
<td>Common Effect vs Random Effect</td>
<td>Prob. LM test Breusch-Pagan &gt; alpha, that is 0.2380 &gt; 0.05</td>
<td>Common Effect</td>
</tr>
<tr>
<td>3</td>
<td>Hausman Test</td>
<td>Fixed Effect vs Random effect</td>
<td>Prob. Cross-section random &gt; alpha, that is 0.8940 &gt; 0.05.</td>
<td>Random Effect</td>
</tr>
</tbody>
</table>

Source: Data processed (2019)

Based on the results of paired testing for each model, the Common Effect Model (CEM) is appropriate for use in the panel data regression model in this study. In this model, the problem of heteroscedasticity must be eliminated by applying the residuals using white-heteroscedasticity. The estimation results of panel data regression are seen through Table 3 below.

Table 3: Estimation of Factors Affecting Earnings Management Common Effect White Cross-Sections (No-Heteroscedasticity) Method

Source: Data processed (2019)
To test the goodness of fit of the regression model used the coefficient of determination ($R^2$). Based on table 3, it is known that the R-squared value is 0.670622 which means that the independent variable has a contribution of 67.062% to the dependent variable and the remaining 32.938% is influenced by other variables not examined in this study. The ANOVA test showed a significance value of 0.000 smaller than the alpha value of 0.05, it can be concluded that this regression model is suitable for predictive models. In addition, a significant F value can mean that simultaneously, CGPI, audit committee, and company size have a significant influence on earnings management.

Furthermore, the estimated panel data regression model used is as follows:

$$Mala = [C_i - 1.447070] - 0.507163 \cdot CGPI - 0.075186 \cdot KA + 0.278885 \cdot Size$$

Partial testing of hypotheses for CGPI and audit committees negatively affect earnings management has not significant. This is evidenced by the probability value greater than the alpha value of 0.5422 and 0.4564. The hypothesis for company size has a significantly positive effect on earnings management. It can be proved that the probability value is smaller than the alpha value of 0.000.

Model 2. For the second model, descriptive data can be seen in Table 4 below.

<table>
<thead>
<tr>
<th></th>
<th>COE?</th>
<th>CGPI?</th>
<th>KA?</th>
<th>SIZE?</th>
<th>MALA?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>0.012843</td>
<td>0.869750</td>
<td>0.347000</td>
<td>7.939000</td>
<td>0.300903</td>
</tr>
<tr>
<td>Median</td>
<td>-0.161532</td>
<td>0.870000</td>
<td>0.330000</td>
<td>8.035000</td>
<td>0.216287</td>
</tr>
<tr>
<td>Maximum</td>
<td>1.958760</td>
<td>0.930000</td>
<td>0.670000</td>
<td>9.020000</td>
<td>1.130559</td>
</tr>
<tr>
<td>Minimum</td>
<td>-0.954539</td>
<td>0.780000</td>
<td>0.140000</td>
<td>6.570000</td>
<td>-0.485731</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>0.640743</td>
<td>0.032304</td>
<td>0.118478</td>
<td>0.767887</td>
<td>0.366049</td>
</tr>
<tr>
<td>Observations</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td>Cross sections</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>8</td>
</tr>
</tbody>
</table>

Source: Data processed, 2019

Based on table 4, it is known that CGPI has an average value of 0.869750 with a standard deviation of 0.032304. The audit committee found an average value of 0.347 with a standard deviation of 0.118478. Firm size has an average value of 7.939, with a standard deviation of 0.7677887. Earnings management has an average value of 0.300903 with a standard deviation of 0.366049. The cost of equity capital has an average value of 0.012843 with a standard deviation of 0.640743. Same as model one, for panel data regression estimation in this study there are three models, namely common effect, fixed effect, and random effect where paired testing is done for each model to determine the right model. Here below is table 5 of the paired test results.
Table 5: Testing Data Regressive Model Panel Equity Capital Cost as Dependent Variable

<table>
<thead>
<tr>
<th>No</th>
<th>Method</th>
<th>Testing</th>
<th>Result</th>
<th>Decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Chow Test</td>
<td>Common Effect vs Fixed Effect</td>
<td>Prob. Cross-section Chi-square &lt; alpha, that is 0,000 &gt; 0,05</td>
<td>Fixed Effect</td>
</tr>
<tr>
<td>2</td>
<td>Langrange Multiplier</td>
<td>Common Effect vs Random Effect</td>
<td>Prob. LM test Breusch-Pagan &lt; alpha, that is 0,0018 &gt; 0,05</td>
<td>Random Effect</td>
</tr>
<tr>
<td>3</td>
<td>Hausman Test</td>
<td>Fixed Effect vs Random effect</td>
<td>Prob. Cross-section random &lt; alpha, that is 0,0354 &lt; 0,05.</td>
<td>Fixed Effect</td>
</tr>
</tbody>
</table>

Source: Data processed (2019)

Based on the results of paired testing for each model, the Fixed Effect Model (FEM) is appropriate for use in the panel data regression model in this study. In this model, the problem of heteroscedasticity must be eliminated by applying the residuals using white-heteroscedasticity. The estimation results of panel data regression are seen through table 6 below.

Table 6: Factors Estimated Affecting the Cost of Equity Capital Method of Fixed Effect White Cross-Sections (No-Heteroscedasticity)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-6.163578</td>
<td>5.074434</td>
<td>-1.214634</td>
<td>0.2347</td>
</tr>
<tr>
<td>CGP1</td>
<td>11.12566</td>
<td>4.847004</td>
<td>2.305568</td>
<td>0.0294</td>
</tr>
<tr>
<td>K4</td>
<td>1.112177</td>
<td>0.570904</td>
<td>1.97749</td>
<td>0.0509</td>
</tr>
<tr>
<td>SIZE?</td>
<td>0.105011</td>
<td>0.193584</td>
<td>-0.54184</td>
<td>0.5894</td>
</tr>
<tr>
<td>MALA?</td>
<td>0.487173</td>
<td>0.219917</td>
<td>2.212523</td>
<td>0.0290</td>
</tr>
<tr>
<td>Fixed Effects (Cross)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>_ANTM-C</td>
<td>-0.032574</td>
<td>0.193584</td>
<td>-0.17184</td>
<td>0.8658</td>
</tr>
<tr>
<td>_BMR1-C</td>
<td>-0.089630</td>
<td>0.201661</td>
<td>-0.4426</td>
<td>0.6594</td>
</tr>
<tr>
<td>_BBNI-C</td>
<td>-0.032624</td>
<td>0.265068</td>
<td>-0.1226</td>
<td>0.9049</td>
</tr>
<tr>
<td>_BBT1-C</td>
<td>-0.032666</td>
<td>0.265068</td>
<td>-0.1226</td>
<td>0.9049</td>
</tr>
<tr>
<td>_BBT2-C</td>
<td>0.265068</td>
<td>0.265068</td>
<td>1.0000</td>
<td>0.3162</td>
</tr>
<tr>
<td>_BBCA-C</td>
<td>-0.0374905</td>
<td>0.105556</td>
<td>-0.3555</td>
<td>0.7249</td>
</tr>
<tr>
<td>_BBRI-C</td>
<td>1.081288</td>
<td>0.219917</td>
<td>4.942523</td>
<td>0.0290</td>
</tr>
<tr>
<td>_NISP-C</td>
<td>0.122041</td>
<td>0.219917</td>
<td>0.5555</td>
<td>0.5794</td>
</tr>
</tbody>
</table>

Effects Specification

Cross-section fixed (dummy variables)

<table>
<thead>
<tr>
<th>Weighted Statistics</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>R-squared</td>
<td>0.694036</td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.573826</td>
</tr>
<tr>
<td>S.E. of regression</td>
<td>0.448996</td>
</tr>
<tr>
<td>F-statistic</td>
<td>5.774004</td>
</tr>
<tr>
<td>Prob(F-statistic)</td>
<td>0.000053</td>
</tr>
</tbody>
</table>
The goodness of fit of the regression model was tested by using the coefficient of determination (R²). Based on Table 4.6, the R-squared value of 0.694036 means that the independent variable has a contribution of 69.4036% to the dependent variable and the remaining 30.5964% is influenced by other variables not examined in this study. ANOVA test shows a significance value of 0.000085 smaller than the alpha value of 0.05. It can be concluded that this regression model is suitable for predictive models. In addition, a significant F value can mean that simultaneously, CGPI, audit committee, company size, and earnings management have a significant effect on the cost of equity capital. Furthermore, the estimated panel data regression model used is as follows:

\[ COE = [C_i - 6,163578] + 11,12566 \times CGPI + 1,112177 \times KA - 0,507953 \times Size \\
\hspace{2cm} + 0,487173 \times Mala \]

Partial testing of the hypothesis CGPI has a negative effect on the cost of equity capital not proven. These results can be seen in the CGPI coefficient value, which is positive, significant and equal to 11.12566. The hypothesis for the audit committee has a negative effect on the cost of equity capital not significant. These results can be seen from the audit committee coefficient of 1.112177. Furthermore, the hypothesis of company size has a positive effect on earnings management is also not significant. These results can be proven from the coefficient value of -0.507953 and significant. Finally, the earnings management hypothesis has a significant positive effect on the cost of equity capital. This result can be proved by the coefficient value of 0.4871723.

**Discussion**

It is known that CGPI and audit committees do not affect earnings management. The results of the research support the results of this study by Susanto and Pradipta (2016), Qi and Tian (2012). Corporate governance applied in companies is only focused on improving company performance because good corporate governance will improve company performance. This was reinforced by Habbash et al. (2013) which states that there is also a possibility that the application of corporate governance is only proposed to fulfil formal requirements. Thus, supervision and monitoring of management performance applied in corporate governance mechanisms are not able to trace and find indications that lead to earnings management practices. Supervision and monitoring of performance are only focused on the purpose of improving the performance of the company so that it is still ineffective in overseeing the company's management performance. Firm size has a positive and significant effect on earnings management. The results of this study are in line with Positive Accounting Theory (Watts & Zimmerman, 1986). One of the hypotheses of the political cost hypothesis states
that large companies that have high political costs are more likely to choose accounting methods to reduce reported profits compared to small companies. It is also supported by the results of study Asih (2014). So, proving that the larger the size of the company, the greater the earnings management carried out by the manager.

Next, CGPI does not negatively affect the cost of equity capital. The results of this study support the results of research by Bozec and Bozec (2010). The statistical results prove that CGPI has a positive and significant effect on the cost of equity capital. Companies that follow the governance ranking program (CGPI) are programs that are voluntarily followed, so that there is an increase in the costs needed to provide information to the public (investors). CGPI is a way to provide information that the company has implemented the principles of good governance. Companies that have good governance will improve performance, and this will give investors more confidence in investing capital. The audit committee also does not negatively affect the cost of equity capital, and this result is in accordance with Siagian and Siregar (2018). According to them, this result might be due to several reasons. First, investors have not paid attention to the effectiveness of the audit committee disclosed in the annual report and still consider the formation of an audit committee limited to compliance with capital market regulations and have not been effective so that they only add costs to the company. Second, companies tend to make good information disclosures only regarding the effectiveness of the audit committee in the annual report even though investors may have their perception that the actual performance of the audit committee is not so good.

The company size does not have a positive effect on the cost of equity capital. The results are in accordance with the results of officers and study of Embong et al. (2012), Botosan et al. (2004). The results have proven that the size of the company has a negative and significant effect, meaning that the larger the size of the company, the smaller the cost of equity capital. Finally, earnings management has a positive and significant effect on the cost of equity capital. These results are supported by the results of study Siregar and Utama (2008), Mazzota and Veltri (2014), Endri and Fathony (2020). This is in accordance with what is the goal of the company to run earnings management to increase the ability to pay the cost of equity capital for investors. The approach taken by the company in its earnings management policies is by maximising profits and increasing the company's ability to generate net cash flows from operating activities so that the company can provide high returns for all investors.

**Conclusion**

The conclusions from the results of this study are: CGPI and audit committees do not negatively affect earnings management. Company size has a positive and significant effect on earnings management. CGPI and audit committees do not have a negative and significant effect on the cost of equity capital. Company size does not have a positive and significant
effect on earnings management. Earnings management has a positive and significant effect on earnings management. The limitations of this study are: The sample used in this study only focuses on companies that follow the CGPI ranking program, making it difficult to generalise to all companies listed on the Indonesia Stock Exchange. The proxy of Corporate Governance used only CGPI and the audit committee. The suggestions for the future research are: For the sample can use other the ranking program of corporate governance or more industries. Another proxy should be used for corporate governance as institutional ownership, managerial ownership, and independent commissioner.
REFERENCES


