THE EFFECT OF THE TYPE OF CONTROLLING SHAREHOLDERS AND CORPORATE GOVERNANCE ON REAL AND ACCRUALS EARNINGS MANAGEMENT

Surifah*

Abstract

This research investigates the relationship between corporate governance and preference of earnings management selected by Indonesian banking controlling shareholders. This study uses all banks listed on Indonesian Stock Exchange from 2006 until 2011 as samples.

The result shows higher real earning managements and lower accruals discretionary in family-controlled banks and private institution compared to government-controlled banks. Government-controlled banks prefer accrual-based earnings management and real activity-based earnings management through operating cash flow. In the other hand, family-controlled banks and private institutions prefer real earnings management through interest expense and discretionary expenses. Foreign-controlled- banks choose earnings management through discretionary expenses.

The implementation of corporate governance in Indonesia banking is high and giving negative impacts both to accrual and real-based earnings management. Concentrated ownership gives positive influences toward the accrual earning management and real earning management through discretionary expenses. The bank size has a positive and significant influence on accrual earnings management, yet its effect is negative and significant on real earning management through interest expenses.

The findings contribute to the development of financial accounting literatures because there are small numbers of previous research on accrual discretionary on family-owned companies. Company does not indicate the increase of earnings quality, but it is indeed indicating that controlling family pays more attention on choosing the real activity-based earnings management to cover the expropriation. Accrual discretionary-based earnings management is intra-period reversely thus it cannot cover the permanent expropriation of controlling owners. The research also contributes to the studies of real-based earnings management measurement in banking system which has not been become a concern of research on previous studies.

Keywords: Corporate Governance, Earnings Management, Type of Controllers

*Cokroaminoto University of Yogyakarta

1 Introduction

Except of United States (US) and United Kingdom (UK), almost all corporations all over the world have a structure of concentrated-ownership and controlled by family (La Porta et al., 1999). The similar structure is also found by Faccio and Lang (2002) in West Europe, except of England and Finland, Latin America, especially Brazil (Roger et al. 2007), and in East Asia, except of Japan (Claessens et al. 2000; and Du and Dai 2005). Indonesia has the similar structure of corporation ownership that is concentrated and controlled by controlling shareholders (Claessens et al. 2000; Fan and Wong 2000; Lukviarman 2004; Siregar 2006; and Sanjaya 2010).

The ownership pattern of corporation which is concentrated and controlled by the controlling shareholders causes agency conflict. It happens because the controlling shareholders tends to give a strong incentive to expropriate corporation's source on minority of non-controlling shareholder (Villalonga and Amit, 2006). The controlling shareholders in Mexico expropriate more than one third of corporation value (Gilson, 2006). This phenomenon also occurs in Indonesia banking case, for example the liquidation of 16 banks in November 1997 and 7 banks suspended its operations in April 2008, Summa Bank liquidated on December 2000, and Century Bank is considered as a failed bank on November 20, 2008 (BPK RI 2009).

Agency conflict between controlling and non controlling shareholder bank has a potential to influence the practice of earnings management. Previous researches find that family control has a negative influence on accrual discretionary-based earnings management (Ali et al. 2007; Atmaja et al. 2011; Bhaumik and Gregoriou 2010; Jiraporn and Dadalt 2009; and Tong 2008), but a strong notion on

shareholder entrenchment exists (Achmad et al. 2009; Oswald et al. 2009; and Sanjaya 2011).

Controlling shareholders probably prefers concealing its private benefits by employing real activity-based earnings management than to use accrual discretionary because accrual-based earnings management is intra-period reversely, thus it cannot conceal permanent private benefits taken by controlling shareholder. Therefore, this research assumes that the type of controlling shareholders have an effect on earnings management practice.

However, the crisis which began in the middle of 1997 caused most of Indonesia public corporations facing disadvantages. The disadvantages appeared due to the non-existence of good corporate governance (Nam and Nam 2004). Therefore many regulations were issued on corporate governance[14]. The implementation of various regulations on corporate governance is expected to be able to protect expropriation by controlling-shareholder and restrict the action of opportunistic earnings management.

Previous researches find the inconsistency on the relationship between corporate governance and earnings management. Corporate governance can restrict earnings management, as stated by (Atmaja et al. 2011; Chtourou et al. 2001; Kang and Kim 2011; Machuga and Teitel 2007; Xie et al. 2002). Corporate governance has a positive influence on earnings management, this statement is investigated by Shah et al. (2009) and Zhao and Chen (2008). Based on the results of previous researches and government's efforts to improve corporate governance, this research assumes that the implementation of corporate governance can restrict the earnings management in Indonesia banking.

This paper contributes to the literature on earnings management, specifically on: 1) the measurement of real activity-based earnings management in banking system and 2) issues about the preference of controlling shareholders on banking industry in selecting earnings management (accrual discretionary or real activity) which have not earned sufficient attention from previous researches.

2 Literature Review and Hypothesis Development

This research based on type 2 of agency theory. This theory explains that agency conflict can occur between controlling shareholders and non controlling shareholders (Lukviarman 2004; Rogers et al. 2007; Zhu and Ma 2009). If controlling shareholders want to maximize their interest, they will expropriate

company resources by sacrificing the interest of non controlling shareholders. Therefore this research assumes that there is a relationship between controlling shareholders, corporate governance, and earnings management.

2.1 Controlling Shareholders and Earnings Management

The main issue on corporate governance in spread ownership is agency conflict between the principal and agent (Morck and Steier 2005), whereas the issue of corporate governance in concentrated ownership and control is agency conflict between controlling shareholder and non-controlling shareholder (Achmad et al. 2009; Almeida and Wolfenzon 2006; Claessens et al. 2002; Giovannini 2010; La Porta et al. 2002; Morck and Yeung 2003; Oswald et al. 2009; Villalonga and Amit 2006; and Zhu and Ma 2009). This agency conflict has a potential to influence financial report in the form of earnings management.

Earnings management is a choice of accounting policies or actions affecting earnings made by a manager, so as to achieve some specific earnings objective (Scott 2012). Earnings management consists of the selection of accounting policy and real activity. The example of earnings management with accounting policy are the selection of depreciation and amortization method, the timing income recognition, and accrual discretionary policy such as recognition of guarantee expense and research and development expenses.

Earnings management based on real activity covers the activities such as advertising expense, research and development, maintenance, and purchase and disposal permanent assets (Scott 2012). Roychowdhury (2006) defines real earnings management as departures from normal business practice aims to meet reporting goals. Manipulation on real activity can be conducted by discounting price and reducing discretionary expenses.

Previous research on the relationship between controlling shareholders and earnings management indicates the inconsistent result. Tong (2008) study on family-owned corporations in US indicates that the companies have 1) lower absolute discretionary accrual, 2) smaller positive earnings surprises, 3) relatively higher earnings information, and 4) lower restating earnings compared to non-family corporations. Jiraporn and Dadalt (2009) support Tong's finding (2008) that family-owned corporations in US have lower abnormal accruals levels compared to those non-family owned corporations. Atmaja et al. (2011) investigates the managers of family-owned corporation in Australia, and find that the managers are less aggressive in managing earnings by employing long term accrual discretionary compared to non-family owned corporations.

Siregar and Utama (2008) use accrual earnings management and find that earnings management types chosen by corporations listed in Indonesia Stock

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14) Regulation on CG for example Minister Decree of State-Owned Enterprises Number 5 of 2006 about the audit board for State-Owned Bank of Indonesia regulation No8/14/2006 on the implementation of GCG for general banks, Capital Market Executive Agency Decree No. Kep-29/pm/2004 on the establishment and guideline to the implementation of audit board performance.

Exchange tends to adopt the efficient earnings management than to opportunist earnings management. Corporations controlled by controlling shareholders relates to the high level of financial report misclassification Haw et al. (2011). Insiders' ownership has significantly positive influences on accrual discretionary-based earnings management in Jordan Al-fayoumi et al. (2010). Based on above literatures, this research assumes that the type of controlling shareholders has an effect on earnings management. Therefore the first hypothesis of this research is: the type of controlling shareholders has an effect on earnings management.

2.2 Corporate Governance and Earnings Management

Brickley and Zimmerman (2010) state corporate governance in a large scope as a law system, regulation, institution, market, contract, policy, and corporation procedure (like internal controlling system, policy guide, and budget) that directly influences the actions of decision makers (shareholder, boards of directors, and management).

Atmaja et al. (2011); Chtourou et al. (2001); Kang and Kim (2011), and Xie et al. (2002), found that audit committee and boards of directors activities, and members' of boards financial experiences are important factors to limit the tendency in performing earnings management. Machuga and Teitel (2007) observe that earnings quality increases after the implementation of corporate governance code. This finding shows that corporate governance can restrict the earnings management behaviors which commence the increase of earnings quality. Huang et al. (2008) prove that strong and independent board of directors may act as a sign that corporations' earnings is qualified. Zhao and Chen (2008) find that weak board of director may cause the managers to enjoy a good life and discourage them to increase corporation value. As a consequence, managers are not motivated to manage earnings. In another case, Shah et al. (2009) indicate positive relationship between corporate governance and earnings management.

Sivaramakrishnan and Yu (2008) indicate that it is a sufficient corporate governance, not the power, that determines the quality of financial report (accrual quality, earnings persistency, and earnings predictability). Jaggi and Tsui (2007) exemplify a positive relationship between earnings management and insider trading after the end of fiscal year. The presence of family members with major ownership in corporation board of director significantly reduces the effectiveness of independent board of director supervision. Therefore the appointment of family members with major shares ownership in the board of director must be avoided in order to increase the independency in the effectiveness of board of director supervision.

A research conducted by Cahan et al. (2008); Chtourou et al. (2001); Huang et al. (2008); Machuga and Teitel (2007); Shah et al. (2009) Xie *et al.* (2002); and Zhao and Chen (2008) employ accrual-based earnings management and find inconsistent evidence on the influence of corporate governance on earnings management. The inconsistency is probably caused by the use of the part of corporate governance mechanism. For example, the use of individual corporate governance mechanism element such as board of directors or audit committee, thus the assessment of corporate governance is less comprehensive. This research measures corporate governance implementation by using index of corporate governance which is more conprehensive (see appendix 1)

Kang and Kim's research (2011) measures corporate governance using index to find evidences that corporate governance can limit the actions of real activity-based earnings management in non-banking and non-financial corporations. This study assumes that corporate governance measured with index in banking will also be able to restrict the action of earnings management. Therefore, the second hypothesis of this research is corporate governance has a negative influence on earnings management.

3 Research Method

This research took a sample from all banks listed in Indonesia stock exchange from 2006 to 2011. Data were collected from annual report, Indonesian Banking Directory, and website of the banks. Data on corporate governance were collected by filling score of corporate governance index.

Research variables consist of earnings management as a dependent variable, types of controlling shareholders, and index of corporate governance as an independent variable. Research control variable used were: 1) percentage of largest shares ownership and 2) size of the bank, which is measured with log asset total.

Earnings management is measured using accrual discretionary and real activity-based earnings management. Real earnings management measurement is derived from Roychowdhury's model (2006), adjusted with banking business. Real earnings management is calculated by regressing operating cash flow, interest expenses, and discretionary expenses, as follow:

$$CFO_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(IR_t/A_{t-1}) + \beta_2(\Delta IR_t/A_{t-1}) + \epsilon_t \tag{1}$$

$$DE_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta(IR_{t-1}/A_{t-1}) + \epsilon_t \tag{2}$$

$$IE_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(IR_t/A_{t-1}) + \beta_2(\Delta IR_t/A_{t-1}) + \beta_3(\Delta IR_{t-1}/A_{t-1}) + \epsilon_t \tag{3}$$

Notes:

CFO_t/A_{t-1} :   Operating cash flow in the year t which is scaled with total assets in the year t-1

$\alpha_1(1/A_{t-1})$:   Intercept scaled with total assets in the year t-1, thus operating cash flow does not have value 0 when trading and lag trading value 0.

IR_t/A_{t-1} :   Interest Revenues in the year t scaled with total assets in the year t-1.

$\Delta IR_t/A_{t-1}$:   Interest revenue in year t minus interest revenue in the year t-1 scaled with assets in year t-1.

IE_t/A_{t-1} :   Interest Expenses in the year t scaled with total assets in the year t-1.

DE_t/A_{t-1} Discretionary expenses in the year t scaled with total assets in the year t-1.

α_0 constanta.

ϵ_t error term in the year t.

From the regression above, the researcher can obtain a normal operating activity cash flow, normal interest expense, and normal discretionary expenses. Earnings management came from operating cash flow, interest expenses, and abnormal discretionary expenses. Therefore, earnings management was calculated by deflating cash flow from real operating activities, actual interest expenses, and real abnormal discretionary expenses with previous year total assets after deducted by operating cash flow, interest expenses, and normal discretionary expenses. Operating cash flow, interest expenses, and normal discretionary expenses are obtained from the equation 1,2 and 3 above.

Accrual discretionary-based earnings management is measured by specific accrual model Beaver and Engel (1996). Non Discretionary Accruals (NDA) is counted with steps:

$$TA_{it} = \alpha_0 + \alpha_1 CO_{it} + \alpha_2 LOAN_{it} + \alpha_3 NPA_{it} + \alpha_4 \Delta NPA_{it+1} + e$$
$$DA_{it} = TA_{it} - [\alpha_0 + \alpha_1 CO_{it} + \alpha_2 LOAN_{it} + \alpha_3 NPA_{it} + \alpha_4 \Delta NPA_{it+1}]$$
$$NDA_{it} = TA_{it} - DA_{it}$$

Notes:

TA_{it} :   Required regulatory provision on productive total assets of bank i In the year t.

DA_{it} :   Accrual managed by bank i in the year t.

CO_{it} :   Loan charge–offs .

LOAN   :   Outstanding loans.

NPA   :   Non performing assets consists of productive assets based on collectability levels: a) Specific oversight, b) Sub Standard, c) Doubtful, and d) loss.

ΔNPA :   Difference in non performing assets t+1 and non performing assets t + all variables deflated with book value of equity plus provision for doubtful debt. Thus to calculate accrual earnings management for proxy: $Da_{it} = TA_{it} - NDA_{it}.$

NDA_{it} :   Non discretionary accruals of bank i in the year t.

Corporate governance as an independent variable is measured using corporate governance index (appendix 1). The higher the index score, the better is the corporate governance. The index corporate governance consist of 15 items, that are the independence of the board of directors, the independence of the president director, accounting and financial competences of the independent board of directors, remuneration and other facilities received by the management, the financial relationships and family relationships between board of directors members, management members, and the controlling stockholder, about the auditing committee, nominating committee, corporate governance committee, about related party transaction, company group structure, and internal auditing.

The type of controlling shareholders consisted of family control, domestic private institution control, foreign institution control, and government control. This variable is measured using dummy variable, with government control as an excluded group. The control by Government of Indonesia is the control by central government and regional government. Bank controlled by a private institution is a bank that belongs to private classification and is not classified as a bank controlled by family. The bank controlled by foreign organization or company is a bank owned by a foreign institution and grouped as foreign bank in Indonesian Bank Directory. The bank controlled by family is a bank with individuals or family as the biggest owners and it is mentioned by Bank Indonesia that the bank ultimate ownership is an individual or a group.

The research used panel data multiple regression analysis. The research model can be formulated into:

$$AEM = \alpha + \beta_1 D\_Fam + \beta_2 D\_Priv + \beta_3 D\_Forg + \beta_4 ICG + \beta_5 Largest + \beta_6 Size + \epsilon$$
$$RCFO = \alpha + \beta_1 D\_Fam + \beta_2 D\_Priv + \beta_3 D\_Forg + \beta_4 ICG + \beta_5 Largest + \beta_6 Size + \epsilon$$
$$RIE = \alpha + \beta_1 D\_Fam + \beta_2 D\_Priv + \beta_3 D\_Forg + \beta_4 ICG + \beta_5 Largest + \beta_6 Size + \epsilon$$
$$RDE = \alpha + \beta_1 D\_Fam + \beta_2 D\_Priv + \beta_3 D\_Forg + \beta_4 ICG + \beta_5 Largest + \beta_6 Size + \epsilon$$

Note:

The excluded group is: government control.

AEM	: Accruals earnings management
RCFO	: Real earnings management through cash flow from operation
RIE	: Real earnings management through interest expenses
RDE	: Real earnings management through discretionary expenses
α	: Constanta.
D_Fam	: Dummy family control.
D_Priv	: Dummy private institution control.
D_Forg	: Dummy foreign control.
D_Gov	: Dummy government control
ICG	: Index of corporate governance.
Size	: bank size or log total assets.
Largest	: Largest ownership percentage:Ownership concentration

4 Results

4.1 Descriptive Statistics

Table 1 of descriptive statistics indicates that the largest control respectively are family 73 (41.95%), private institution 58 (33.33%), government 24 (13.80%), and foreign 19 (10.92%). Family-controlled banks including individual is the biggest portion among all types of control.

The maximum value of corporate government index is 14 (93.33%) and the minimum value is 11 (73.33%). This index consists of 15 questions, the higher ICG score the better is the Good Corporate Governance (GCG) implementation. The average score of 13.37 exemplifies that the implementation of GCG in banking system is pretty high i.e. 89.13% (13.37/15). Minimum value, 11 banks, demonstrates the lowest GCG value is 73.33% (11/15). There is no absolute ICG score 100% (15).

Table 1. Descriptive Statistics

Notes	D_Fam	D_Gov	D_Priv	D_Forg	ICG (%)	Largest
Mean	0.425	0.138	0.333	0.109	89.13	0.596
Median	0	0	0	0	90.00	0.573
Maximum	1	1	1	1	93.33	100%
Minimum	0	0	0	0	73.33	0.154
Std. Dev.	0.496	0.346	0.473	0.313	3.068	0.207
Skewness	0.302	2.100	0.707	2.506	-0.914	0.137
Kurtosis	1.091	5.410	1.500	7.281	4.236	2.588
Sum (N)	73	24	58	19		
Sum of N (%)	41,95%	13,80%	33,33%	10,92%		
Observations	174	174	174	174	174	174
Cross sections	29	29	29	29	29	29

Note	SIZE	AEM	RCFO	RIE	RDE
Mean	13.248	-0.065	-0.017	0.029	-0.051
Median	13.213	-0.181	-0.072	0.101	-0.144
Maximum	14.949	2.965	2.983	2.974	2.991
Minimum	11.621	-1.312	-2.923	-2.973	-0.719
Std. Dev.	0.781	0.544	0.932	0.828	0.528
Skewness	0.098	3.234	0.423	-1.176	3.204
Kurtosis	1.950	18.357	5.031	7.363	17.416
Observations	174	174	174	174	174
Cross sections	29	29	29	29	29

Note: AEM: Accruals earnings management, RCFO: Real earnings management through cash flow from operation, RIE: Real earnings management through interest expenses, RDE: real earnings management through discretionary expenses, largest: ownership concentration.

Ownership concentration level, which is measured with the largest ownership percentage, indicated maximum value of 100% and minimum value of 15.4%. This means that ownership structure of banks in Indonesia is mostly concentrated in the controlling owner. La Porta et al. (1999) employs

ownership cut off 10% and 20% to be able to control the corporation. The average value of ownership is 59.58% and the median value is 57,3% increasingly support previous findings stating that Indonesia ownership structure is concentrated (Claessens et al. 2000; Fan and Wong 2000; Lukviarman 2004; Siregar 2006; and Sanjaya (2010). Corporation size is proxied using log total assets with the minimum value of 11.62, maximum value of 14.95, average 1value of 3.25, and median value of 13.21.

4.2 The Relationship Between Type of Control and Corporate Government on Accrual Earnings Management

Regression result in table 2 shows that accruals earnings management (AEM) performed by banks controlled by family, private, and foreign institution is significantly lower than AEM of banks controlled by government. This finding indicates that banks controlled by family, private, and foreign institution do not prefer accrual-based earnings management whereas government bank prefers to accrual earnings management.

Table 2. The Effect of Type of controlleers and CG on Earnings Management

Independent Variable	Dependent Variable			
	AEM	**RCFO**	**RIE**	**RDE**
Constant	-1.060	2.802	4.708	-1.256
	(-2.58)	(2.36)	(5.97)	(-2.09)
D_fam	-0.286	-0.429	0.335	0.223
	(-3.41)***	(-2.65)***	(2.69)***	(2.43)***
D_Priv	-0.279	-0.546	0.276	0.216
	(-3.44)***	(-3.42)***	(2.46)***	(2.44)***
D_Forg	-0.286	-0.545	0.129	0.219
	(-3.39)***	(-2.69)***	(0.254)	(2.06)**
ICG	-0.012	-0.043	-0.044	-0.006
	(-1.76)*	(-1.93)**	(-3.81)***	(-0.71)
Largest	0.150	-0.159	-0.047	0.487
	(1.66)*	(-0.51)	(-0.27)	(3.91)***
Size	0.131	-0.082	-0.186	0.074
	(5.86)***	(-0.85)	(-3.28)***	(1.83)*
N	174	174	174	174
Adj. R^2	0.238	0.104	0.313	0.074
F-statistic	10.022***	1.609**	14.141***	3.305***

*, **, *** Indicate significance at the 10, 5, and 1 percent levels, respectively.
The "t" statistics are identified in parenthesis.

There are several possibilities explaining the lower AEM in family control, private, and foreign institution as follows: **first,** AEM has been an old issue for accountants, thus it possibly draws a lot of auditors and regulators' attention. Financial executives perform a strong urge to manipulate earnings by preferring real activity to accrual, the reasons are: a) accrual manipulation has a big possibility to attract auditors or regulators attention than decisions on costs and productions, b) relying on merely accrual is risky. Low level of income below the minimum limits in the end of the year can be manipulated using accrual. However, if the end of the year's revenue drops below the limits, real activity cannot be manipulated in the end of the year (Graham et al. 2005 and Roychowdhury 2006). **Second**, accrual manipulation is reverse inter-period which is in consequence it cannot cover permanent expropriation conducted by the family, private, and foreign institution-owned corporations.

Government-controlled bank that use AEM is significantly larger than family, private, and foreign institution -controlled bank. This exemplifies government preference to use AEM. The high use of

AEM in government banks is assumed to have some reasons:

a) Professional managers in government bank have a stable career, thus they tend to be loyal with their career. Their accrual manipulations are not for opportunistic reasons but tend to provide signals for a better performance in the future. This situation is in line with (Gunny 2010) who shows that corporations involved in earnings management only to meet the earnings benchmark have higher performances in next years compared to corporations not involved in earnings management and lose their earnings benchmark. Therefore, earnings management performed is not for opportunistic reasons but more for giving signals about a better performance in the future.

b) Real activity manipulation has a long term economic consequence. Roychowdbury (2006) suggests that real activity manipulation can reduce corporation value due to the actions is performed in ongoing year to increase revenue. This may give negative effects on next period cash flow. For example, aggressive discounts to increase trading volume and to fill short term earnings target may

cause customers to wish similar discount in the future. Customer expectation of discounts in the future can be defined as a lower margin in trading. Overproduction generates over supplies that means corporation has to sell more and to charge bigger supply expenses in the next period.

Corporate governance index has a negative influence (sign. < 10%) on AEM which means that if the good corporate government is well-implemented, the lower the AEM. The finding shows that corporate governance implementation can restrict AEM actions. Ownership concentration has a positive influence (Sign. < 10%) on AEM which means the more concentrated the ownership, the bigger AEM will be. Corporation size has positive (Sign. < 1%) influences on AEM, it means the larger the corporation, the bigger its AEM.

This result is appropriate with finding from Xie *et al.* (2002), Chtourou *et al.* (2001), Kang and Kim (2011), and Atmaja *et al.* (2011) that shows that the mechanism of corporate governance, which consist of audit committee and boards of directors activities and members' of boards financial experiences are important factors to limit the tendency in earnings management.

4.3 The Relationship between Type of Control and Corporate Governance to Real Earnings Management

Based on the result of regression in table 2, it is known that family, private, and foreign institution control have a significant lower real earnings management through operating cash flow compared to government control as an excluded group. The result indicates that government-owned banks prefer to use real activity-based earnings management through RCFO whereas family, private, and foreign institutions control prefer not to employ this type of earnings management.

Family control and private institutions apparently choose real earnings management through interest expense and discretionary expense. Family and private institution control have a significantly higher RIE and RDE (sign. 1%) compared to RIE and RDE in government controlled banks. Foreign control prefers earnings management through discretionary expenses (*Sign.* < 5%) compared to government control as an excluded group.

Corporate governance index has negative and significant influences on real earnings management through RCFO and RIE. It means the better good corporate governance implementation, the lower real earnings management through RCFO and RIE. It indicates that the implementation of corporate governance can restrict the earnings management through RCFO and RIE.

Ownership concentration level does not significantly influence RCFO and RIE but has a positive and significant influence on RDE, which

means the more concentrated an ownership, the bigger the real earnings management through discretionary expenses. Corporation size has a negative and significant influence on RIE, meaning that the larger the corporation size, the lower the real earnings management through interest expense. The size has a positive and significant influence on RDE, meaning that the larger the corporation, the higher the RDE.

Based on the findings above, it can be concluded that government control prefers accrual-based earnings management and real activity based-earnings management through RCFO, while family and private institution control tends to choose real earnings management through RIE and RDE. Foreign control takes RDE. Corporate governance index has a negative and significant influence on AEM, RCFO, and RIE and does not influence RDE. Ownership concentration has positive and significant influences on AEM and RDE but does not influence RCFO and RIE. Bank size has positive and significant influences on AEM and RDE but has negative and significant influences on RIE.

5 Conclusion

These research findings indicate that most of Indonesia banking is controlled by family (41.95%) and private institution (33.33%). Private institution control has the same preference with family control in choosing earnings management. This is possibly caused by the fact that behind private institution control, family control occurs. However, this research does not uncover the facts because of limited data on indirect bank ownership.

Corporate governance implementation presents a high result, 89%, means that banks in Indonesia have implemented corporate governance rules and principles well. The result indicates that corporate governance has negative and significant influences on AEM, RCFO, and RIE but does not influence RDE. It means that the better the good corporate governance, the AEM, RCFO, and RIE implementation will be lower. Corporate government can restrict earnings management actions through AEM, RCFO, and RIE.

Government control prefers accrual-based earnings management and real activity-based earnings management through RCFO, whereas family and private institution control prefer real earnings management through RIE and RDE. Foreign control prefers RDE. This research finds that ownership structure of Indonesia banks is strongly concentrated, with the largest ownership average 59.58%. The findings support previous research conducted by (Claessens *et al.,* 2000; Fan and Wong, 2000; Lukviarman, 2004; Siregar, 2006; and Sanjaya, 2010). Ownership concentration does not influence RCFO and RIE but has positive influence on AEM and RDE which may mean the more concentrated the ownership, the bigger AEM and RDE will be.

Bank size has positive and significant influences on AEM and RDE which means the larger corporation is the larger AEM and RDE. Bank size has negative and significant influences on RIE means that the larger the bank size, the lower the possibility of real earnings performed by management through interest expenses.

The limitation of this research lies in the sample, in which this research only take samples from the banks listed in IDX. Therefore next research can enlarge the samples into all Indonesia or Asia banking. This research does not study the reasons why each of controller types has diverse preferences in earnings management. Thus, the future research can examine this issue.

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Appendix1. Corporate Governance Bank Index

No.	Questions	Scoring
1	The number of independent directors is divided by all board of directors (BI 2006), (BI 2007)	≥50% 1, < 50% 0
2	The president director is independent (BI, 2007).	Yes 1, no 0
3	Accounting and financial competences of the independent board of directors (BI, 2006 &2007).	Yes 1, no 0
4	Board of Directors members has financial and family relationships to other board of director members, of management and/or controlling stockholder disclosured (BI, 2006)?	Yes 1, no 0
5	Are remuneration and other facilities received by the management disclosed? (BI, 2007)	Yes 1, no 0
6	All members of management stated their financial and family relationships to board of directors members, to management members and/or to the controlling stockholder (BI, 2007).	Yes 1, no 0
7	Is the auditing committee led by an independent person? (BI, 2007)	Yes 1, No 0
8	Are roles and responsibilities of committees clearly described? (BI, 2007).	Yes 1, no 0
9	Did the auditing committee monitor and evaluate the auditing plan and realization and the follow-up of the auditing result to judge internal controlling sufficiency and the process of financial report? (BI, 2007).	Yes 1, no 0
10	Do the executive member of nominating committee understand a bank nominating system and succession plan? (BI, 2007).	Yes 1, no 0,
11	Are the roles and responsibilities of CG committee clearly described? (Ananchotikul, 2007)	Yes 1, no 0
12	Does the bank have a clearly written policy, system, and procedure on how to provide fund to related party and provide big fund and the monitoring and problem solving? (BI, 2007).	Yes 1, no 0
13	Does the bank disclose the company group structure? (Ananchotikul, 2007)	Yes 1, no 0
14	The bank has an internal auditing standard operating procedure (SPFAIB) (BI, 2007).	Yes 1, no 0
15	The bank made a task force of internal auditing and a manual for internal auditing (BI, 2007).	Yes 1, no 0