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Penulis : Heni Agustina, Rizki Amalia Elfita, Djoko Soelistya, Ninnasi Muttaqin, Mochamad Mochklas

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Website : lppm.unusa.ac.id

Email : lppm@unusa.ac.id

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The role of corporate governance in earnings persistence: Audit committee as a moderation variable

Heni Agustina^{a*}, Rizki Amalia Elfita^a, Djoko Soelistya^b, Ninnasi Muttaqin^a and Mochamad Mochklas^c

^aLecturers, Universitas Nahdlatul Ulama Surabaya, Indonesia

^bLecturers, Universitas Muhammadiyah Gresik, Indonesia

^cLecturers, University of Muhammadiyah Surabaya, Indonesia

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During the current Covid-19 pandemic, it is undeniable that many companies are experiencing a decline in turnover, and some companies have even been forced to go out of business. Due to the many fraud incidents, corporate governance is vital in ensuring earnings persistence by considering many audit committee structures. Based on this phenomenon, the purpose of this study is to determine how significant the role of corporate governance is in overcoming earnings persistence moderated by the number of audit committees. This study is quantitative descriptive with a population of all companies listed on the Indonesia Stock Index (IDX), and the number of samples with several criteria found as many as six companies. This research period was conducted from 2011-2019. This result implies a positive influence on corporate governance moderated by the audit committee on earnings persistence. This led to point out that the power of corporate governance has a positive effect on earnings persistence.

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1. Introduction

During the current Covid-19 pandemic, it is undeniable that many companies are experiencing a decline in turnover, and some companies have even been forced to go out of business. This is because many investors have withdrawn their shares in the company. Therefore, a few companies have made various approaches to attract investors' interest even though on the wrong track. The fraudulent practice of disclosing financial statements has occurred in almost all parts of the world and Indonesia. One of the cases of manipulating financial information is PT Jiwasraya, which falsified the income statement 2006 Jiwasraya stated earnings. Still, the earnings were incorrect, and in 2017 the related party recorded gains of Rp. 360.6 billion, but the company received an *adverse opinion* due to a deficiency of Rp. 7.7 billion. However, in 2018 the BPK revealed that the company lost Rp. 15.3 trillion until November 2019 and the company experienced equity of Rp. 27.2 trillion (Liputan6.com, Jakarta). With many examples of fraud, the regulator has shifted their attention to the audit committee's existence. The audit committee is one of the significant determinants of these frauds. Utama (2004) states that the audit committee's role and function need to be improved to realize corporate governance pillars and increase financial reports' transparency. One of the financial statements

* Corresponding author.

E-mail address: heni@unusa.ac.id (H. Agustina)

highlighted is earnings, where investors' objective is to invest in getting dividends. From company earnings, investors can also assess the company's management performance achievement. Such an important role is the earnings information that can be vital for investors' decisions. The process of compiling these earnings involves many parties, including management, board of commissioners, and shareholders (Arif et al., 2020; Nugroho et al., 2020, 2021; Barth & Hutton, 2001). Presumably, earnings quality is influenced by the existence of an audit committee and corporate governance. The awareness of the importance of audit committees, corporate governance, and earnings quality are the benchmarks for the authors to choose this topic. The author feels the need to conduct a study related to the relationship between corporate governance and earnings persistence moderated by the audit committee.

2. Literature Review

2.1 Agency Theory

Jensen and Mackling (1976) state that agency theory arises when one or more people (principal) employ other people (agents) to provide services and delegate decision making to the agent. Or in other words, the management is the agent, and the investor/shareholder is the principal.

Corporate Governance versus Earnings Persistence

According to Khafid (2012), corporate governance is more effective in monitoring management because of policies used to advance the company. This means that corporate governance will provide oversight to company management to achieve company goals, namely obtaining persistent earnings. Improved corporate governance will strengthen the quality of company earnings in terms of earnings persistence. Corporate governance regulates policies that can increase company earnings. Hence stakeholders can develop different strategies to increase company earnings. Khafid's (2012) research supports that companies' corporate governance is significantly proven to affect earnings persistence.

H₁: *Corporate governance influences on earnings persistence.*

Corporate Governance, the Persistence of Earnings moderated by the Audit Committee

Audit Committee reliability is one way that can be done to increase company earnings. According to Nasution and Setiawan (2007), the concept of a corporate governance mechanism is carried out to improve company performance through supervision or monitoring of management performance and ensuring management accountability to stakeholders based on policies that apply to the company. In line with that, corporate governance structure describes the distribution of each party's rights and responsibilities involved in a business, namely the Board of Commissioners and Directors, Managers, Shareholders, and other related parties as stakeholders. Jao and Pagalung's (2011) research results state that companies with competent audit committee members can influence earnings management actions; additionally, corporate governance is needed to develop the company. Audit and corporate governance committees play an essential role in increasing company earnings. Based on this explanation, it can be concluded as follows.

H₂: *Corporate governance influences on earnings persistence moderated by the audit committee.*

Conceptual framework

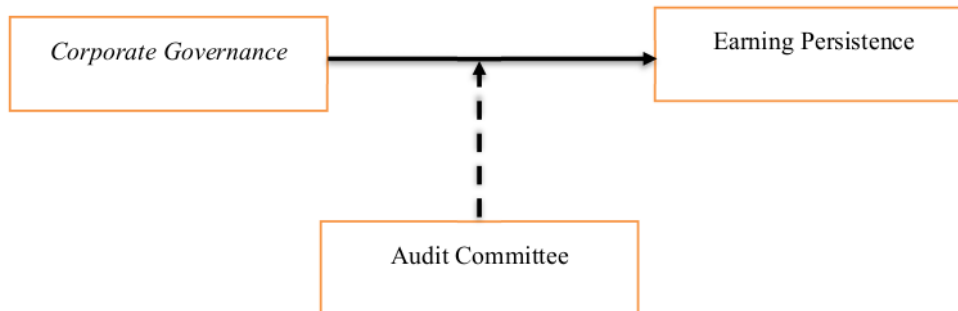


Fig. 1. Conceptual Framework

3. Method

This type of research is descriptive quantitative. Sugiono (2018) states that the quantitative method is a method that uses statistical data in the form of numbers. The population in this study were all companies listed on the IDX, with the sample

criteria, namely (1) companies that received a CGPI rating issued by IICG (2) consistent with the publication of financial reports during 2011-2019 as many as six companies.

4. Operational Definition and Measurement of Variables

4.1 Earnings Persistence

Earnings persistence results from the revision of expected future earnings, which is compared or associated with the current year's earnings innovation (Scott, 2009). If the persistence of accounting earnings $(\beta_1) > 1$ indicates that solid gains are highly persistent. If the industry of profits $(\beta_1) > 0$ suggests that the company's revenues are constant. Conversely, earnings persistence $(\beta_1) \leq 0$ means that company earnings are fluctuating and not persistent.

Independent Variable

Corporate Governance

Current procedures of corporate governance can be measured using the Corporate Governance (CG) index number published by the Indonesian Institute for Corporate Governance (IICG), which is called the corporate governance perception index (CGPI). CGPI is an index number formulated based on ten aspects as a measure of the quality of the implementation of corporate governance and according to the application of the concept adapted from the pascal adaptation of 7s McKinsey on several aspects of assessment, including the following: commitment to implementing corporate governance, transparency in disclosing information, accountability responsibility, independence, fairness, the competence of company administrators and supervisors, company mission statement, top management leadership, and staff collaboration. Corporate governance is proxied by CGPI

Moderation Variables

Audit Committee

By the Kep. 29 / PM / 2004, the audit committee is a committee that the board of commissioners has formed to carry out any supervisory activities over the management of a company (Suryan, 2012).

Table 1
Audit Committee

Variable	Formula	Information	
Earnings Persistence	$PTBI_{t+1} = \alpha + \beta_1 PTBI_t + e$	$PTBI_{t+1}$ = Accounting earnings before tax period, $t+1$ (pre tax book income) A = Constant β_1 = Regression coefficient $PTBI_t$ = Current period accounting earnings before tax e = Error terms	Hanlon, (2005)
<i>Corporate Governance</i>		A score of 85-100 for the Very Trusted category Score 70 - 84 for the Trusted category Score 55 - 69 for the type Trustworthy Enough	Corporate governance perception index (CGPI)
Audit committee	Audit committee = number of audit committees		(Suryan, 2012; Sujana, 2017; Klein, 2002; Davies & Parker, 1995)

5. Descriptive Statistical Analysis

Descriptive analysis is descriptive statistics that use data analysis to describe data that has been collected as it already exists without intending to make general conclusions (Sugiono, 2018).

5.1 Classic assumption test

The classical assumption test is needed to test the hypothesis using multiple regression analysis. The classical assumption test includes; normality test, multicollinearity test, autocorrelation test, heteroscedasticity test, and hypothesis test.

In this study, normality test results showed a Kolmogorov-Smirnov Z value of 0.807 or lower than the label value of 1.960 (0.807 < 1.960) asymp value. Sig (2-tailed) of 0.532, which is greater than the significance value (0.05), can be concluded that the research data is normally distributed. Multicollinearity test results show the overall tolerance value of audit committee variables, corporate governance, and corporate governance affect the earnings persistence moderated by the audit committee above 0.10 (> 0.10). The VIF (Variance Inflation Factor) results also show the overall value of audit committee variables;

corporate governance affects the earning persistence moderated by audit committees under 10. Thus it can be concluded that the equation model does not experience multicollinearity disorders. This study has autocorrelation test results showing Durbin-Watson score of 1,406, Du= value= 1,320 and 4-Du= 1,466. Durbin-Watson's score of 1,406 is between (1,320 – 1,466) (Ghozali, 2018). Thus, the substructure equation model 1 is free from autocorrelation problems. The heteroskedasticity test results showed each independent variable's significance value greater than 0.05 (>5%). Thus it can be concluded that the substructure equation model 1 used in this study does not contain heteroskedasticity disorders.

6. Discussion

The influence of corporate governance moderated by the audit committee on earnings persistence has a value of 0.001. A significance value of 0.001 indicates that the value is less than $\alpha = 0.05$. This results in a positive influence on corporate governance moderated by the audit committee on earnings persistence. Thus, the hypothesis is accepted. This study's results support the research conducted by Utama (2004) stated that the audit committee's role and function need to be improved to realize the pillars of corporate governance and increase environmental reports' transparency. One component of the financial statements highlighted is profit, which is investors' purpose of investing in dividends. Therefore, corporate governance has a significant influence on the earnings persistence moderated by the audit committee. The audit committee's role can shape policy on corporate governance where the role can influence stakeholders to determine policies and increase the company's profit. The audit committee also has a significant and strategic role together with independent commissioners to maintain the credibility of the process of preparing financial statements, overseeing external audits, and monitoring internal control systems, as well as maintaining the creation of an adequate corporate supervision system and the implementation of Good Corporate Governance (GCG). The effectiveness of audit committees will increase if the size of the audit committee increases. More audit committees have more resources to deal with companies' problems so that the quality of financial reporting increases. The audit committee is also responsible for overseeing financial statements, supervising external audits, and observing internal control systems (including internal audits) can reduce the opportunistic nature of management conducting earnings management by supervising financial statements and supervising external audits.

Table 2
Result Regression

Variable	Sig.
Corporate governance → Earnings persistence	0.001
Audit committee × Corporate Governance → Earnings persistence	0.001

A corporate governance mechanism is carried out to improve the company's performance through supervision or monitoring of management performance and ensure management accountability to stakeholders by basing on policies applicable to the company. Therefore, the structure of corporate governance explains the distribution of each party's rights and responsibilities involved in a business, namely the Board of Commissioners and Board of Directors, Managers, Shareholders, and other parties concerned as stakeholders. In general, companies that have a competent composition of audit committee members can influence profit management actions. Still, also there needs to be corporate governance for mutual progress in the company. In general, the earnings persistence reflects the quality of the company's profit, which indicates that the more earnings persistent earned by the company, the greater the profit expected by investors. Investor reaction is higher to information that is expected to be consistent in the long run. While the influence of corporate governance has a value of 0.001, a significance value of 0.001 indicates that the value is less than $\alpha = 0.05$. This results in a positive influence on earnings persistence. This study's results support the research of Khafid (2012), which showed that corporate governance affects earnings persistence, and Febiani (2012) concluded that institutional ownership, managerial ownership, and audit quality partially positively affect earnings persistence. So that corporate governance and policies made and objectives made by stakeholders can affect the earnings persistence. This is because the policies that apply in the company increase or decrease the company's profit. The policy taken can be seen from the company's profit so that stakeholders can consider the following steps to increase its profit. Good Corporate Governance is an effort to motivate management to increase effectiveness and, at the same time, control management behavior to keep hearing the interests of stakeholders in terms of mutual agreement. Good Corporate Governance (GCG) is expected to improve the quality of the company's profit. The quality of the company's profit is good if the quality of the profit can describe the company's actual state. The excellent quality of the company's profit will have a positive impact on the company and investors because the company's reported profit will not fool investors, and the company will earn more investors because the company has a good quality of profit. Corporate governance is more effective in monitoring management due to policies that are used to advance the company. Corporate governance is a system that regulates and controls companies that are expected to provide and increase the value of the company to shareholders. Thus, the implementation of good corporate governance is believed to increase the value of the company. Effective corporate governance in the long term can improve the company's performance and benefit

shareholders. It means that corporate governance will provide supervision to the company's management to achieve its goal of obtaining earnings persistence.

Increased corporate governance will strengthen the quality of the company's profit in terms of earnings persistence. Corporate governance regulates policies that can increase the company's profit so that stakeholders can build the following strategy to increase its profit. This is supported by Khafid's research (2012) that corporate governance within the company significantly affects earnings persistence. Corporate governance can also create added value for interested parties (stakeholders) in the form of adequate protection, especially to investors in regaining their investments in a reasonable and high value.

7. Conclusion

From this study, it can be concluded that corporate governance affects earnings persistence. Therefore, corporate governance, policies made, and stakeholders' objectives can affect earnings persistence. This is because the applied policies in the company affect increasing or decreasing company earnings. The influence of corporate governance moderated by the audit committee on earnings persistence has a positive effect. The audit committee's role can shape corporate governance policies in which this role can influence stakeholders to determine policies and increase company earnings. Thus, companies need to improve corporate governance and increase the audit committee's ability to improve its financial performance.

8. Limitations and Future Studies

This research has been attempted and carried out by scientific procedures, but still has limitations that:

1. The factors that affect earnings persistence in this study consist of only two variables: corporate governance and audit committee. At the same time, many other factors affect earnings persistence.
2. The limitations of research using data from IDX are that sometimes the sample's research results do not show the actual state.

Researchers are further advised to use other variables and develop variables in this study. This research can be used as a further reference and as a consideration for further research.

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