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THE IMPLEMENTATION OF GOOD CORPORATE GOVERNANCE MODEL AND AUDITOR INDEPENDENCE IN EARNINGS' QUALITY IMPROVEMENT

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Abstract. The general objective of this research is to explore the model of earnings quality monitoring and to examine the effect of auditor independence on the relationship between *corporate governance* mechanism and earnings quality. Specifically, this research is aimed to investigate the impact of ownership structure, commissioner board structure, audit committee structure, internal audit function, and internal control activity, on earnings quality by involving an interaction of these variables with auditor independence. Earnings quality is measured with two proxies. The first proxy is *performance-adjusted discretionary accruals* or also called *Total Accrual*, while the second utilizes *Total Current Accrual*. Achieving all objectives above, the author develops a model and analyses this model in two stages. In the first stage, the model is explored using analysis technique of correlation and regression. Second, fittingness of model is attested using regression analysis with a variety of variable controls and sample controls. Research object is the manufacture companies listed in Indonesia Stock Exchange in period 2011-2015. The Sample includes 112 companies with 560 data of research. After conducting outlier test, the suitable amount of data is 553. The Result of hypothesis test indicates that the model of earnings quality monitoring is constructed from the interaction of many variables. *Corporate governance* mechanism consists of variables such as ownership structure (managerial ownership and institutional ownership), commissioner board structure, audit committee structure, internal audit function, and internal control activity. Adjusted R-Square value is reaching for 3.3% with significance-value of 0.001. Partially, commissioner board structure, internal audit function, and internal control activity have a significant effect on earnings quality. Auditor independence does not moderate the impact of *corporate governance* components on earnings quality.

Keywords: auditor independence; corporate governance; discretionary accrual; earnings quality

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1. Introduction

Profit and Loss Statement is a structure to communicate financial information to the relevant parties out of the company. The primary focus of this statement is information about company performance, and this performance is known by measuring income and its components. Investors, creditors, and other parties with interest in assessing incoming cash-flow would have great necessity on information about company performance (Mulford & Eugene, 2010; Masiulevičius & Lakis, 2018).

Some parties may already be informed over others about company condition, but such information usually does not match with the real situation of the company. Management (agent) is a party with a responsibility to manage all resources available in the company. Therefore, agent must know more about the company than the owner (principal) or other stakeholders. The owner always gets information from the report made by the agency. This relationship leads to a situation called information asymmetry. Imparity situation and the potential conflict of interest between company management and financial information user can be avoided by using a third party (neutral) to audit earnings-loss statement to improve the quality of financial information given by management (Sumarwoto, 2006). The study can contribute to the understanding of the effect of auditor independence on a relationship between governance mechanism and earnings quality in a particular agency setting. They might be of interest to practitioners and regulators, as they are consistent with calls for more earnings quality requirements in this agency setting (Allegrini, 2013).

Audit Standard has required an auditor to discuss and communicate with audit committee about the desired earnings quality. This effort would reduce the possibility of opportunistic earnings management and also of material misrepresentation. Role of the auditor on earnings quality would be more meaningful if the auditor is independent. People trust given to auditor's verification of an earnings-loss statement is determined by auditor's competence and independence (Watt & Zimmennan, 1986; Tarasova et al., 2018). According to Marra, A., Mazzola, P. and Prencipe, A. (2011) board independence and audit committees play an important and effective role in reducing earnings management after the introduction of IFRS.

Empirical evidence shows that the application of *corporate governance* is related more to company performance and less with earnings quality. If any connections whatsoever, the relationship is not consistent (Larcker et al., 2007; GMI, 2005). The role of the auditor and internal control and the effect of both on earnings quality are also far from being clear (Hoitash et al., 2009; Lin et al., 2011). Based on the review of previous studies, two “gaps” are found. First is the debate on the direct effect of *corporate governance* on earnings quality. Second, some researches still examines the object partially, such as *corporate governance* and stock return (Brown & Caylor, 2004; Larcker et al., 2007); *corporate governance* and internal control (Jenning et al., 2006; Bedard & Graham, 2008; Hoitash et al., 2009; Nagy, 2010); *corporate governance* and earnings quality (Larcker et al., 2007); auditor and earnings management (Teoh & Wong, 1993; Francis & Yu, 2009); auditor and audit quality (Abbott et al., 2007; Francis & Yu, 2009); auditor and earnings quality (Jerry & Mark, 2010; Lin et al., 2011); auditor and internal audit (Bedard & Graham, 2008); and internal audit and internal control (Lin et al., 2011). All researchers above do not comprehensively investigate the role played by ownership structure, internal audit function, internal control activity, and auditor independence in the model of earnings quality monitoring. Therefore, the formulated problem in this research would be, "How shall be the fittest model that describes the role of *corporate governance* mechanism, ownership structure, internal audit function, internal control activity, and auditor independence in earnings quality monitoring?"

The general objective of this research is to explore the model of earnings quality monitoring and to examine the effect of auditor independence on a relationship between *corporate governance* mechanism and earnings quality. The specific objective of this research is to investigate the effect of ownership structure, commissioner board

structure, audit committee structure, internal audit function, and internal control activity, on earnings quality by using auditor independence as moderating variable.

Financial statement (earnings-loss) can be used as a structure for monitoring the contract between *agent* and *principal*. This statement is useful not only for agent and principal, but also for other users including investors, creditors, employees, customers, governments, and communities (IAI, 2015). The financial statement shall contain reliable information which then is used as the base in making an economic decision. Therefore, such statement must have what so-called qualitative characteristic.

During a condition of uncertainty, the financial statement in desired quality can reduce information asymmetry in agency contract involving agent and principal, or also in the relationship between agent and other stakeholders. Indeed, information asymmetry brings a risk of poor decision-making on economic issues. According to Scott (2003), the risk of information asymmetry is caused by two factors, respectively *adverse selection*, and *moral hazard*. The proof that *moral hazard* exists can be detected from the presence of *earnings management* done by *the agent* or from the relationship between agent and principal which harms the user of the financial statement. The presence of *earnings management* would provide great indication of lower earnings quality.

Earnings management is an option made by the manager when they are making policy or selecting accounting method, but this option would impact on earnings or also on the achievement of specific goals of the managerial statement (Scott, 2003). Empirically, earnings quality can be measured by the presence of *earnings management*. Feng, Kristian, Qinytuan, & Xin (2011) have used three proxies in estimating earnings quality. The first proxy is *performance-adjusted discretionary accruals* developed by Kothari, Leone, & Wasley (2005). The second is *discretionary revenues*, a model made by McNichols & Stubben (2008) and Stubben (2010). The third proxy is a model constructed by Dechow & Dichev (2002) as modified by Francis et al., (2005). Based on the results of some previous studies, it is indicated that earnings quality is affected by some factors. These factors are: the application of *corporate governance* (Larcker et.al., 2007; GMI, 2005; Jennings et. al., 2006), the involvement of high-quality auditors (Francis & Yu, 2009; Teoh & Wong, 1993; Abbott et.al., 2007), internal audit function and internal control activity (Nagy, 2010) and auditor independence (Watt & Zimmerman, 1986; Scott & Marshall, 2001). Earnings accuracy is one of the key factors affecting a firm's sustainability in the sense that reported earnings provide information about a firm's long-term sustainability and further are directly associated with a firm's cost of capital (Shin, 2019).

Corporate governance mechanism is needed to ensure that company has performed well, went in the right direction, and been managed without abuse. *Corporate governance* has once been public attention when the public start to learn the financial crisis suffered by East Asia countries and the fall of Enron and WorldCom (Pirzada, 2013). *Good Corporate governance* becomes then a robust regulation model in the financial market (Anuchitworawong, 2010). The presence of *good corporate governance* (GCG) is absolutely required by an organization, considering GCG requires a good governance system which can assist in building shareholder confidence and ensure that all stakeholders are treated equally. A good system will provide effective protection to shareholders to recover their investment reasonably, appropriately and efficiently, and ensure that management acts for the benefit of the company (Mahrani, 2018)

Most regulations and corporate governance codes emphasize the adjective independent next to the words auditor because auditor independence is expected to result in better protection for shareholders and other stakeholders (Ianniello, 2015). Based on Watt & Zimmennan (1986) view of auditor independence has perceived that people trust to verification given by the auditor on the earnings-loss statement is determined by auditor's competence and independence. Auditor competence is concerning with professional reliability of auditor individual. It requires the auditor to have a technical skill which enables the auditor to always keep on track the violation of the existing

accounting system. Meanwhile, auditor independence involves auditor to have less-biased perceptions of any things related to audit results by Solikhah, Firmansyah & Pirzada, (2017). Independent auditor shall be the protector of the empowering accounting practices because auditor is not only considered as having a profound knowledge in accounting field but also perceived as having close relationship with anyone in audit committee and director board who are responsible for checking up the activity of the decision-makers in the company (Scott & Marshall, 2001).

Based on theories previously elaborated and the findings of previous studies, then the hypothesis of research is developed (Pirzada, 2015), and it can be described as follows.

- Managerial Ownership, Institutional Ownership, Commissioner Board Structure, Audit Committee Structure, Internal Audit Function, and Internal Control Activity, affect Earnings Quality.
- Managerial Ownership, Institutional Ownership, Commissioner Board Structure, Audit Committee Structure, Internal Audit Function, Internal Control Activity, and Auditor Independence, affect Earnings Quality.
- Managerial Ownership, Institutional Ownership, Commissioner Board Structure, Audit Committee Structure, Internal Audit Function, and Internal Control Activity, with Auditor Independence as moderating variable, affect Earnings Quality.

Research population is the manufacture companies that have been listing in Indonesia Stock Exchange from 2011 to 2015. This population contains 138 companies. Sampling technique is *purposive sampling*, and it is applied to all manufacture companies by criteria. The criteria involve listing in Indonesia Stock Exchange from 2011 to 2015 and having the complete data of research variables. Some companies that meet sampling criteria is attaining 112 companies with 560 research data. After conducting outlier test, the suitable amount of data is left only 553.

Data collection method in this research is documentation. Many annual reports are compiled, and it includes the report to commissioner board, report to director board, report of *corporate governance* implementation, internal control statement, internal audit statement, balance sheet, earnings-loss statement, and cash-flow statement, as well as notes for the financial statement. Some data are derived from the collection of investment gallery at STIE Malangkeucwara, and others are acquired from the publications of Indonesian Capital Market Directory. The completion of data is ensured by examining websites of Indonesia Stock Exchange and discerning *yahoo finance*.

Some variables are subjected to observation. These are described as follows.

- a. *Corporate Governance Structure*. The proxies of this variable include Managerial Ownership (% of stock ownership); Institutional Ownership (% of stock ownership); Commissioner Board Structure (% of the independent member); and Audit Committee Structure (% of the independent member).
- b. *Internal Audit Function*. This variable is measured with some proxies, such as: Quality Assurance (reported = 1; not-reported = 0); Formal Follow-Up (reported = 1; not-reported = 0); Coordination with Audit Committee and/or Auditor (reported = 1; not-reported = 0); and Education Background of Internal Auditor (accounting = 1; not-accounting = 0).
- c. *Internal Control Activity*. Proxies that measure this variable are: Disclosure of Control Environment (disclosed = 1; not-disclosed = 0); Disclosure of Risk Assessment (disclosed = 1; not-disclosed = 0); Disclosure of Control Activity (disclosed = 1; not-disclosed = 0); and Disclosure of Information, Communication and Surveillance (disclosed = 1; not-disclosed = 0).
- d. *Auditor Independence*. The measurement of this variable is done with dummies, such as value 1 = independent and value 0 = not-independent. Data of independence have been acquired from review report by Public Accountant Offices (PAO) and Network of Foreign Public Accountant Offices (NFPAO).
- e. *Earnings Quality*. In this research, this variable is measured with two proxies.

First proxy is *performance-adjusted discretionary accruals*. This proxy is developed by Kothari et.al. (2005). The estimated model of this proxy is:

$$TAccr_{i,t} = \alpha_0 + \alpha_1(1/Assets_{i,t-1}) + \alpha_2\Delta Rev_{i,t} + \alpha_3PPE_{i,t} + \alpha_4ROA_{i,t} + \varepsilon_{i,t}, \dots(1)$$

$TAccr_{i,t}$: Total Accrual; measured as the change of *non-cash current assets*, subtracted from the change of *non-interest-bearing current liabilities*, subtracted by depreciation & amortization of company *i* at year *t*. The result is then scaled with the lag of total assets ($Assets_{i,t-1}$);

$\Delta Rev_{i,t}$: The change in annual revenue. It is scaled with the lag of total assets ($Assets_{i,t-1}$);

$PPE_{i,t}$: Property, Plant, and Equipment of company *i* at year *t*. It is scaled with the lag of total assets ($Assets_{i,t-1}$)

$ROA_{i,t}$: *Return on Assets* of company *i* at year *t*.

The second proxy is model suggested by Dechow & Dichev (2002) which is then modified by Francis et al., (2005), and Feng et al. (2011).

Specifically, model is estimated as follows:

$$TCAccr_{i,t} = \alpha_0 + \alpha_1OCF_{i,t-1} + \alpha_2OCF_{i,t} + \alpha_3OCF_{i,t+1} + \alpha_4\Delta Rev_{i,t} + \alpha_5PPE_{i,t} + \varepsilon_{i,t} \dots\dots\dots (2)$$

$TCAccr_{i,t}$: Total Current Accruals; measured as the change of *non-cash current assets*, subtracted from the change of *non-interest-bearing current liabilities*. The result is then scaled with the lag of total assets ($Assets_{i,t-1}$);

OCF : Operational Cash Flow; measured as the sum of net earnings, depreciation & amortization, and the change of current liabilities, subtracted from the change of current assets. Result is then scaled with the lag of total assets ($Assets_{i,t-1}$)

$\Delta Rev_{i,t}$: The change in annual revenue. It is scaled with the lag of total assets ($Assets_{i,t-1}$)

$PPE_{i,t}$: Property, Plant, and Equipment of company *i* at year *t*. It is scaled with the lag of total assets ($Assets_{i,t-1}$)

Residual of the regression model is *discretionary accruals*. In this regression, the author uses the absolute value of *discretionary accruals* (DisAccr) as KKK proxy. This value is then multiplied by -1.

Classic Assumption Test

After subjecting the regression model to classical assumption test, it is found that the model has met the conditions required by multicollinearity test, autocorrelation test, heteroscedasticity test, and normality test. By these results, then the regression model is considered as fit.

Descriptive Statistic Test

The following table indicates the result of descriptive statistic test. This test is conducted to understand minimum rate, maximum rate, mean rate, and standard deviation of earnings quality, either in total

accrual or total current accrual approaches in 112 companies on five observation periods (2011-2015) (Table 1).

Table 1. Descriptive Statistics

	N	Min.	Max.	Mean	Std. Dev.
Earnings Quality 1	553	-.95	.00	-.1981	.12858
Earnings Quality 2	553	-.90	.00	-.0866	.11516
Man-Own	553	.00	90.00	3.1398	12.21998
Inst-own	553	.00	.99	.6925	.22158
Comm-BS	553	.00	1.00	.4301	.16008
Aud-Com.S	553	.00	1.00	.3529	.11705
Audit-IF	553	2.00	4.00	3.3454	.60647
IC-Act.	553	.00	4.00	2.7396	1.04821
IndepAud	553	.00	1.00	.8264	.37911
Valid N (list-wise)	553				

Of 112 go-public manufacture companies, earnings quality level (KLK) in total accrual approach has given the mean rate of -0.1981, the minimum rate of -0.95, the maximum rate of 0.00, and standard deviation of 0.12858. Earnings quality level in total current accrual is giving the mean rate of -0.866, the minimum rate of -0.90, the maximum rate of 0.00, and standard deviation of 0.11516. Based on the results of two approaches, it can be said that mean rate of total current accrual is better than that given by total accrual.

Managerial Ownership has the mean rate of 3.1398 with the standard deviation of 12.21998. This position shows that managerial ownership in manufacture companies that listing in Indonesia Stock Exchange is very low, and as a consequence, full control over company policies is less optimum. Institutional Ownership has the mean rate of 0.6925 with the standard deviation of 0.22. It signifies a condition that institutional ownership of the manufacture companies that listing in Indonesia Stock Exchange is very low, and thus, full control over company policies is less optimum. Commissioner Board Structure has the mean rate of 0.431 with the standard deviation of 0.16.

Equation 1:

$$EQ = \alpha + \beta_1 \text{Man-Own} + \beta_2 \text{Ins-Own} + \beta_3 \text{Comm-BS} + \beta_4 \text{Aud-Com.S} + \beta_5 \text{Audit-IF} + \beta_6 \text{IC-act} + \varepsilon \dots\dots\dots (1)$$

Table 2. GCG Models To Earning Quality

		Earnings Quality 1 with TAcc Approach				Earnings Quality 2 with TAcc Approach			
R		.209 ^a				.099 ^a			
R Square		.044				.010			
Adjusted R Square		.033				-.002			
F		3.961				.867			
Sig.		.001 ^a				.519 ^a			
		Std.				Std.			
		B	Std. Error	t	Sig.	B	Error	t	Sig.
1	(Constant)	-.258	.031	-8.256	.000	-.040	.022	-1.786	.075
	Man-Own	-.001	.000	-1.497	.135	.000	.000	.493	.622
	Inst-Own	.003	.021	.156	.876	-.007	.015	-.492	.623
	Comm-BS	.090	.025	3.602	.000*	.017	.018	.904	.366
	Audt-Com.S	.038	.034	1.113	.266	-.017	.025	-.697	.486
	Aud_IF	.002	.007	.271	.786	-.005	.005	-.975	.330
	IC-Act	.007	.004	1.783	.075**	-.003	.003	-1.234	.218

^a Predictors: (Constant), IC-Act, Man-Own, Comm-BS, Audt-Com.S, Aud-IF, Inst-own

* significant at 5% level

** significant at 10% level

As shown in the Table 2 above, the independent variables will include Managerial Ownership, Institutional Ownership, Commissioner Board Structure, Audit Committee Structure, Internal Audit Function, and Internal Control Activity. These variables explain Earnings Quality at 3.3% level, while the remaining percentage is affected by another variable. Partially, Managerial Ownership and Institutional Ownership do not have a significant effect on Earnings Quality. This situation is supported by Arniati and Mardiyah (2008) who stated that managerial ownership does not influence income smoothing, and the presence of income smoothing signifies the condition of lower earnings quality. Audit Committee Structure, measured by the proxy of the independence of audit committee members, is not significantly influencing Earnings Quality. This finding is supported by Amin (2017) who found that audit committee does not affect earnings quality.

The result of analysis, however, indicates that Commissioner Board Structure, measured by the proxy of the independence of commissioner board, has a significant effect on Earnings Quality at 5% level. This position aligns with the findings of previous researchers, such as Fama & Jensen (1983); Sharma (2004); Abdul Rahman & Ali (2006); Osma & Nogueer (2007); Osma (2008); Jaggy et al (2009); Lo, Wong & Firth (2010), and Prastiti & Wahyu (2013). Empirically, earnings quality can be measured by the presence of earnings management (Feng, Kristian, Qinytuan, & Xin, 2011). Internal Audit Function, with its proxies involving quality assurance, regular follow-up, coordination with the audit committee, and education background of internal auditor, has a significant effect on Earnings Quality at 10% level. Internal Control Activity has a significant positive effect on Earnings Quality at 10% level. The effectiveness of *corporate governance* is closely related to internal control (Hoitash & Bedard, 2009). The company with weak *corporate governance* always fails to detect or disclose material weakness. Bedard & Graham (2008) delivered evidence that management only is not enough to identify internal control weakness, and even, 84% proportions of material weakness are successfully detected by the auditor (Table 3).

Equation 2:

$$EQ = \alpha + \beta_1 \text{Man-Own} + \beta_2 \text{Ins-Own} + \beta_3 \text{Comm-BS} + \beta_4 \text{Aud-Com.S} + \beta_5 \text{Audit-IF} + \beta_6 \text{IC-act} + \beta_7 \text{Indep-Aud} + \varepsilon \dots\dots\dots (2)$$

Table 3. GCG Model and Auditor Independence

		Earnings Quality 1 with TAcc Approach				Earnings Quality 2 with TCAcc Approach			
R		.218 ^a				.111 ^a			
R Square		.047				.012			
Adjusted R Square		.035				-.001			
F		3.694				.923			
Sig.		.001 ^a				.488 ^a			
		B	Std. Error	t	Sig.	B	Std. Error	t	Sig.
1	(Constant)	-.253	.031	-8.034	.000	-.037	.022	-1.641	.101
	Man-Own	-.001	.000	-1.430	.153	.000	.000	.552	.581
	Inst-Own	.010	.022	.475	.635	-.003	.015	-.194	.847
	Comm-BS	.089	.025	3.539	.000*	.015	.018	.834	.405
	Aud-Com.S	.042	.034	1.210	.227	-.016	.025	-.652	.515
	Audit-IF	.001	.007	.179	.858	-.005	.005	-1.002	.317
	IC-act.	.009	.004	2.215	.027*	-.002	.003	-.792	.429
	IndepAud	-.018	.011	-1.573	.100**	-.010	.008	-1.198	.232

^a Predictors: (Constant), IC-act., Man-Own, Comm-BS, Aud-Com.S, Audit-IF, Inst-Own, Indep.Aud

* significant at 5% level

** significant at 10% level

When the variable of Auditor Independence is set into Model of Good Corporate Governance, the result shows that the effect of independent variables on earnings quality becomes greater. This result is signified by the increase of Adjusted R-Square from 3.3% to 3.5% based on KLK measurement with Total Accrual approach. The role of the auditor on earnings quality is more meaningful if the auditor is independent. People trust given to auditor's verification on the earnings-loss statement is determined by auditor's competence and independence (Watt & Zimmennan, 1986). The partial result indicates that auditor independence has a significant effect on earnings quality at 10% level. Commissioner Board Structure and Internal Control Activity are consistently and significantly influencing Earnings Quality at 5% level. Independent auditor shall act as the protector of the empowering accounting practices because the auditor is not only having knowledge in accounting field but also building a close relationship with members in audit committee and director board who have a responsibility to follow the track of decision-makers in the company (Scott & Marshall, 2001) (Table 4).

Equation 3:

$$EQ = \alpha + \beta_1 \text{Man-Own} + \beta_2 \text{Ins-Own} + \beta_3 \text{Comm-BS} + \beta_4 \text{Aud-Com.S} + \beta_5 \text{Audit-IF} + \beta_6 \text{IC-act} + \beta_7 \text{Indep-Aud} + \beta_8 \text{Man-Own*Indep} + \beta_9 \text{Ins-Own*Indep} + \beta_{10} \text{Comm-BS*Indep} + \beta_{11} \text{Aud-Com*Indep} + \beta_{12} \text{Audit-IF*Indep} + \beta_{13} \text{IC-act*Indep} + \varepsilon \dots\dots (3)$$

Table 4. GCG Model with Auditor Independence as a moderating variable

	Earnings Quality 1 with TAcc Approach				Earnings Quality 2 with TAcc Approach			
R	.200				.099			
R Square	.040				.010			
Adjusted R Square	.016				-.014			
F	1.700				.402			
Sig.	.0057				.969			
	B	Std. Error	t	Sig.	B	Std. Error	t	Sig.
1 (Constant)	-.247	.122	-2.017	.044	-.229	.110	-2.091	.037
Man-Own	9.175E-5	.001	.112	.911	-3.090E-5	.001	-.042	.966
Inst-Own	-.021	.068	-.308	.758	.002	.061	.034	.973
Comm-BS	.178	.089	1.995	.047*	.094	.080	1.180	.238
Aud-Com.S	.091	.158	.574	.566	.025	.142	.176	.860
Audit-IF	-.017	.029	-.585	.559	.036	.026	1.392	.165
IC-act.	.001	.017	.067	.947	-.007	.015	-.494	.621
IndepAud	0.014	.132	.105	.917	.178	.118	1.512	.131
M-own_Indep	-.001	0.001	-1.058	0.290	0.00	0.001	0.150	0.881
Ins-own_Indep	.010	.076	.133	.894	-.012	.068	-.184	.854
ComBS_Indep	-.087	.097	-.897	.370	-.080	.087	-.918	.359
Aucom_Indep	-.056	.166	-.337	.736	-.056	.148	-.377	.706
Aud IF_Indep	.004	.030	.125	.901	-.044	.027	-1.622	.105
AIC_Indep	.013	.018	.700	.484	.009	.016	.548	.584

^a Predictors: (Constant), Man-Own, Inst-Own, Comm-BS, Aud-Com.S, Audit-IF, IC-act., IndepAud, M-own_Indep, Ins-own_Indep, ComBS_Indep, Aud.com_indep, Aud.IF_Indep

* = significant at 5% level

When Earnings Quality is measured with Total Accrual approach, the result indicates that independent variables are significantly influencing earnings quality at 5% level. When Total Current Accrual is used to measure earnings Quality, independent variables do not show a significant effect on earnings quality. The model above confirms the fact that Auditor Independence does not moderate the effect of Commissioner Board Structure, Internal Audit Function, and Internal Control Activity on Earnings Quality. In this position, Earnings Quality is directly influenced by Commissioner Board Structure, Internal Audit Function, and Internal Control Activity without the moderation of Auditor Independence.

Discussion

Theoretically, the involvement of auditor can reduce information asymmetry and potential conflict of interest between the management of the company and the user of financial information. Therefore, the presence of auditor shall improve the quality of financial information reported by management (Sumarwoto, 2006). The auditor will verify that earnings-loss statement has been made in the manner of fairness and compliance with Financial Accounting Standard (FAS), and also reflect "truly conditions" of economic and operational aspects of the company. The auditor is also required by audit standard to discuss and communicate about the desired earnings quality with the audit committee, and by such activity, it would reduce the possibility of opportunistic earnings management and also the risk of material misrepresentation (Jerry & Mark, 2010).

Conclusions

Commissioner Board Structure, which is measured by the proxy of the independence of commissioner board, is significantly influencing Earnings Quality at 5% level. Internal Audit Function, with its proxies involving quality assurance, regular follow-up, coordination with the audit committee, and education background of internal auditor, has a significant effect on Earnings Quality at 10% level. It can be said that the presence of auditor would improve the quality of financial information reported by management (Sumarwoto, 2006). Internal Control Activity has a significant positive effect on Earnings Quality at 10% level. The effectiveness of *corporate governance* has a close relationship with internal control. The company with weak *corporate governance* is always difficult to detect or disclose material weakness. Bedard & Graham (2008) have given a proof that company management if they have required skill, can only identify minor proportion of internal control weakness because 84% proportions of material weakness are successfully detected by the auditor.

Managerial Ownership and Institutional Ownership do not have a significant effect on Earnings Quality. This finding is supported by Arniati and Mardiyah (2008) who found that managerial ownership is not influencing income smoothing, and income smoothing signalize lower earnings quality. Audit Committee Structure, which is measured by the proxy of the independence of audit committee members, does not significantly influence Earnings Quality. This finding is supported by Amin (2014) who asserted that audit committee does not affect earnings quality. This research the common managerial ownership 3.14% and institutional ownership 0.69%. It's too small, so the influence to earning quality is not significant.

By putting Auditor Independence into Good Corporate Governance Model, the effect of independent variables on earnings quality is getting bigger. Auditor Independence does not moderate the effect of Commissioner Board Structure, Internal Audit Function, and Internal Control Activity on Earnings Quality.

The result of this research shall give the proper theoretical contribution to the principles underlying the relationship of principal-agent-stakeholders through the instrument of the earnings-loss statement. This research is expected to produce the fittest model of earnings quality monitoring, respectively a model which predicts that the company with the higher level of accountability and transparency is one with the capability to produce the reliable quality of financial information.

The limitation of this research is that the author does not have access to data concerning with ownership structure of key stockholders. Therefore, the author is in the difficult position to measure ownership concentration. Besides, the author also does not have access to data of the result of assemblies held by Commissioner Board. Thus, it would limit the capacity of the author to measure Commissioner Board assemblies and other related variables.

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