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The Impact of Disclosure Quality on Corporate Governance and Earnings Management: Evidence from Companies in Indonesia

Citrawati Jatiningrum[1]*, Mohamad Ali Abdul-Hamid[2], Oluwatoyin Muse Johnson Popoola[3]

[1]STMIK Pringsewu, Lampung, Indonesia, [2]Tunku Puteri Intan Safinaz School of Accountancy, College of Business, University Utara Malaysia, Malaysia, [3]Tunku Puteri Intan Safinaz School of Accountancy, College of Business, University Utara Malaysia, Malaysia. *Email: citrawati1980@gmail.com

ABSTRACT

This paper investigates the relationship between corporate governance and earnings management with disclosure quality as a moderating variable in the scenario of highly concentrated ownership and less protected investors. The data obtain from listed Indonesian manufacturing companies using moderated regression analysis method complete the analysis of the interaction effects. The results reveal a significant effect of disclosure quality on the relationship between corporate governance mechanisms and earnings management. This study shows that disclosure quality and good corporate governance can reduce earnings management manipulation. The results are expected to contribute significantly to the existing knowledge on the concentrated ownership among companies on corporate governance, disclosure quality, and earnings management. Also, the findings will assist policy makers and regulators to facilitate directions for manufacturing sector and their operations in the future.

Keywords: Disclosure Quality, Corporate Governance, Earnings Management, Developing Country

JEL Classifications: M40, M41, M49

1. INTRODUCTION

Prior accounting research focuses primarily on agency conflict, arising from misalignment of interests between agent and principal. Agency conflict is one of the focus of good corporate governance. In a contemporary financial analysis in accounting research, an issue on agency conflict Type II takes the key position. However, discussion about agency conflict Type II remains poorly developed in accounting literature. Similarly, research on the association between corporate governance and disclosure, is still scanty in non-Anglosaxon countries. Despite the lack of rigorous empirical evidence, good corporate governance effectively mitigates agency problem, especially the agency conflicts between the controlling shareholder and minority shareholders. Recent finance theory presents a powerful argument that the central of agency problem in large corporations around the world is that of restricting expropriation of minority shareholders by controlling shareholders (La Porta et al., 1999, 2000; Shleifer and Vishny, 1997). Thus, concentrated ownership structures give rise to a new form of conflict of interest between dominant shareholders and minority shareholders. Many of the corporations in Asia countries are owned and controlled by families (Shleifer and Vishny, 1997; La Porta et al., 1999; Zhuang et al., 2000), and thus, the major agency problem exists between the management (the controlling family) and minority shareholders.

Better governance is supposed to lead to a better corporate performance by preventing the expropriation of controlling shareholders and ensuring better decision-making. This expropriation results in the smoothening of earning intention, which is known as earnings management. According to the university of technology Sydney research theme, "corporate governance is not just about the process by which elected representatives such as directors make decisions." It is also about the way organizations are held accountable. The most obvious way is through financial reporting (Shah et al., 2009 cf: UTS Research

Theme-2). Reasoning from this discussion, it is clear that quality of corporate governance is positively related to earnings management (Shah et al. 2009; Liu and Lu, 2007).

Prior research provides some evidence for this argument. Shen and Chih (2007) studies the impacts of corporate governance on earnings management in nine Asian countries. They found that firms with good corporate governance tended to engage in fewer earnings management. Also, Ikechukwu (2013) argues that companies with stronger internal management, such as higher ownership concentration and smaller boards, manage earnings more, while firms with stronger external governance, such as higher institutional holdings and high takeover pressure, manage earnings less. Liu and Lu (2007) strongly suggest that agency conflicts between controlling shareholders and minority investors account for a significant for earnings management. Soheilyfar et al. (2014) argue that firm with a stronger system of corporate governance and appropriate monitoring may have more ability to impact on management to disclose more and better information. Based on the existing disclosure theory, Shehata (2014) considers that the monitoring role of a disclosure of a firm is influenced by the firm's monitoring mechanisms.

Klapper and Love (2004) state that to prevent management and controlling shareholders from engaging in the expropriation of minority shareholders; firms could improve investor protection rights by increasing disclosure, select well-functioning independent boards, and impose disciplinary mechanism appropriately. The corporate governance function of disclosure is relatively weak in Asia's emerging markets. Most of the accounting research found that the strength of this feature relies on external governance mechanisms such as shareholder litigation (Francis et al., 2008). Furthermore, Shah et al. (2009) studies throw some light on corporate governance features that enhance incentives for proper disclosure under high ownership concentration.

In this regard, our purpose of this study is to provide empirical evidence on the importance of disclosure quality about good corporate governance, especially in emerging market of Asia. This study also gives evidence that disclosure quality has an effect on the relationship between corporate governance and earnings management practice in the context of agency conflict Type II, based on Indonesian context. The study provides evidence to the investors that they can rely on corporate governance mechanisms for protection against being expropriated by corporate insiders. This suggests that disclosure quality is vital in monitoring corporate effectiveness to better corporate governance mechanisms aimed at reducing earnings management.

2. LITERATURE REVIEW

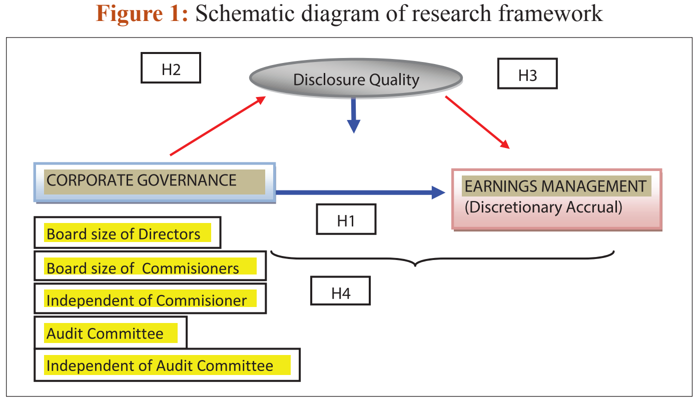
Cheung and Chan (2004) state that corporate governance refers to the system through which the behavior of a company is monitored and controlled. The significance of corporate governance is that, in modern economies, large corporations are typically associated with a division of labor between the parties who provide the capital (shareholders) and the parties who manage the resources (management). Findings have shown that poor corporate governance was one of the major contributors to the building up of vulnerabilities in the affected countries that finally led to the Asian financial crisis in 1997 (Zhuang et al., 2000). In East Asia countries, there is the prevalence of weak corporate governance in the five worst-affected countries, namely Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand largely as a result of highly as a result of highly concentrated ownership structure (Claessens and Fan, 2002). The high concentration of ownership reduces the effectiveness of some important mechanisms of shareholder protection, such as the system of the board directors, shareholder participation through voting during shareholder meetings, transparency, and disclosure.

Yaghoobnezhad et al., (2011) investigate the relationship between earnings management and corporate governance dimensions (strength and adequacy) at Tehran stock exchange listed companies. This study emphasizes that strengthening of various corporate governance mechanisms can improve informativeness of financial reports and reduce agency problems. Shen and Chih (2007) investigate the impacts of corporate governance on earnings management of nine Asian countries. The result of their study showed that: Firms with good corporate governance tend to conduct fewer earnings management, there is a significant effect of size on earnings smoothing and highly leveraged firm with poor governance have a high tendency of manipulating earnings. Other findings are that firms with higher growth (lower earnings yield) are prone to engage in earnings smoothing and earnings aggressiveness which good corporate governance can mitigate the effect and finally, firms with stronger anti-director rights countries tend to exhibit stronger earnings smoothing. The theoretical research framework is illustrated in Figure 1.

2.1. Corporate Governance and Earnings Management

Corporate governance is characterized by a set of mechanisms that effectively protect investors from opportunistic behavior (Shleifer and Vishny, 1997; Denis and McConnell, 2003; Gillan, 2006). The literature on the linkage between corporate governance and earnings management has remained inconsistent. Chang (2008) study shows that aggregate corporate governance is significantly and positively (negatively) related to earnings management. Findlay (2006) indicates that the of independence of the board of directors and audit committees determine the magnitude of earnings manipulations as both play a significant role in

Figure 1: Schematic diagram of research framework



constraining the level of earnings management. On the contrary, Klein (2000) finds a negative association between earnings management and the percentage of outside directors on board and audit committees, whereas Xie et al. (2003) reported that no association exists. Shen and Chih (2007) argue that presence of good corporate governance tend to lead to fewer earnings management. Thus, the hypotheses develop are:

H1a: There is a significant negative relationship between the size of the board of director and discretionary accrual.

H1b: There is a significant negative relationship between board size of the commissioner and discretionary accrual.

H1c: There is a significant negative relationship between independent commissioner in the board and discretionary accrual.

H1d: There is significant negative relationship between audit committee and discretionary accrual.

H1e: There is a significant negative relationship between independent audit committee and discretionary accrual.

2.2. Corporate Governance and Disclosure Quality

Shah et al. (2009) examine the effect of combined set of corporate governance mechanism with disclosure quality. Based on the of the context of minority expropriation arising from ownership concentration, they found a negative association between disclosure quality and family control, double voting shares, and the duo of ownership and control concentration. Shah et al., (2009) further finding shows a positive relationship between disclosure quality, the presence of executive stock options plans and proportion of independent directors on the board as well. This indicates that corporate governance mechanisms enhance proper disclosure under high ownership concentration. Amoozesh et al. (2013) study report a positive effect on corporate governance system quality on the disclosure quality. Soheilyfar et al. (2014) explores the relationship between disclosure quality and corporate governance. Their findings show that it is significant and positive relationship between disclosure quality and internal audit, ownership concentration, CEO duality, board independence and chairman independence. They reported no association between disclosure quality, board size, and chairman tenure. Thus, the hypotheses develop are:

H2a: There is significant positive relationship between board size of director and disclosure quality.

H2b: There is significant positive relationship between board size of commissioner and disclosure quality.

H2c: There is significant positive relationship between independent commissioner in the board and disclosure quality.

H2d: There is significant positive relationship between audit committee and disclosure quality.

H2e: There is significant positive relationship between independent audit committee and disclosure quality.

2.3. Disclosure Quality on Relationship between Corporate Governance and Earnings Management

Lobo and Zhou (2001) give empirical evidence indicating that corporate disclosure and earnings management are significantly negatively related. Fan and Lang (2002) argue that agency Type II conflict leads to controlling shareholders to report accounting information based on self-interest, which results in less credibility of reported earnings as perceived by outside investors. Thus, higher disclosure quality reduces the incentives to search for private information by reducing the expected benefits from obtaining private information.

Consequently, Ali (2007) states that under high ownership concentration and poor investor protection environment, controlling shareholders are less concerned about minority shareholders and may easily expropriate them, particularly when strong voting rights lies with giving controlling shareholders which allow them total control of the firm. Therefore, controlling shareholders have fewer incentives to disclose information on firms leading to lower disclosure which leads to the high tendency of earnings management by firms (Lobo and Zhou, 2001). Thus, the hypothesis is developed as follow:

H3: Disclosure quality has negative relationship with discretionary accrual.

Cormier et al. (2012) study highlights that managers who engage in earnings management are less inclined to be transparent in their disclosure practice and vice versa. This shows that management's discretionary ability to manage earnings increases as the information asymmetry between management and shareholders increases. Thus, the hypothesis developed is as follows:

H4: Disclosure quality mitigates the relationship between corporate governance and discretionary accrual.

3. THE METHODOLOGY AND MODEL

3.1. Sample and Data Sources

The study sample is obtained from financial reports and annual reports during 2009-2013 (5 fiscal years) of 35 sampled manufacturing companies drawn from Indonesia stock exchange (IDX). The study adopted purposive judgment sampling technique. Accordingly, 175 firm observations are used for the analysis.

3.2. Measuring Independent Variables

Corporate Governance mechanism:

a. Board size of directors (BSIZE), is the number of directors of the board
b. Board size of commissioner (BCOM), is the number of commissioners on the board members
c. Independent of commissioner (INDCOM) is a percentage of independent commissioner over the total number of a board member
d. Audit committee (AC) is the proportion of independent audit committee members
e. Independent of the audit committee (INDAC) is the number of independent Audit Committee
f. Firm size is the control variable measured as the natural logarithm of total asset of the firm at the end of the fiscal years
g. Leverage is the control variable measured as the total debt liabilities over total assets
h. Growth is the control variable measured as sum of years from company establish.

3.3. Measuring Dependent Variable (Earnings Management)

This study used the modified Jones's model (Dechow et al., 1995) to measure the level of earnings management or discretionary accruals (DTAC). This model used total accruals (TAC) that are classified as discretionary components (DTAC) and non-discretionary components (NDTAC). Thus, defined as follows:

TAC = NDTAC + DTAC

Where:
TAC = Total accrual period t
NDTAC = Value of non-discretionary accruals
DTAC = Discretionary accrual

Under the cash flow approach, total accruals are measured as follows:

$$TACC_{it}=EBXT_{it}-OCF_{it} \quad (1)$$

Where:
$EBXT_{it}$ = Earnings before extraordinary items and discontinued operations period t
OCF_{it} = Operating cash flow for period t

The total value of accruals is estimated by OLS regression equation as follows:

$$TAC_t/TA_{t-1}=a_1[1/TA_{t-1}]+a_2[\Delta REV_t/TA_{t-1}]+a_3[PPE_t/TA_{t-1}]+\varphi \quad (2)$$

Value of non-discretionary accrual (NDTAC) can be calculated by the formula:

$$NDTAC=\alpha_1[1/TA_{t-1}]+\alpha_2[(\Delta REV_t-\Delta REC_t)/TA_{t-1}]+\alpha_3[PPE_t/TA_{t-1}] \quad (3)$$

Furthermore, DTAC can be calculated as follows, obtained the value of discretionary accruals that are residuals of the estimated total accrual.

$$DTAC=TAC_t/TA_{t-1}-NDTAC \quad (4)$$

Where:
TAC = Total Accruals in period t
NDTAC = Value of non-discretionary accrual
DTAC = Discretionary accrual
REV Δ_t = Change in net sales in period t
REC Δ_t = Change in period t net receivables
PPE = Property, plan, and equipment
a_1 a_2 a_3 = Coefficient of regression Equation (2)
$\alpha_1\alpha_2\alpha_3$ =Fitted coefficient obtained from the regression Equation (2)

3.4. Disclosure Quality

Disclosure quality as a moderating variable in this study. This variable is measured according to standard and poor's transparency and disclosure index (S&P T&D index). The index has been used and found reliable for emerging market in Latin America and Asia. S&P T&D index consist of 98 possible information items or attributes which are broadly divided into three sub-categories which are: Ownership structure and investor rights (28 attributes), financial transparency and information disclosure (35 attributes), board and management structure and process (35 attributes) (Patel and Dallas, 2002). The measures of T&D quality of the sample firms are content-analyzed to confirm their presence or not from item disclosed in company annual report, financial statement and website of the sampled firms. The existence or not is rated "Yes" indicated by 1 or "No" indicated by 0 respectively with total number of items rated yes indicated by 1 expressed as a percentage of the maximum possible 'yes' answer in each category following Aksu and Kosedag (2006):

$$TDS=\Sigma j\Sigma kSjk/TOTS \quad (5)$$

Where:
J = The attribute category subscript
K = The info item (attribute) subscript and
TOTS = The total maximum possible "yes" answers for each firm
Sjk = The number of info items disclosed (answer as "yes") by the firm in each category.

4. THE FINDINGS

4.1. Descriptive Statistic

Table 1 provides some descriptive statistics about sample firms. Descriptive statistics is always used for depicting the characteristics of sample size. Results of Kolmogorov-Smirnov test showed that all variables are normally distributed. From Table 1, of all the ten variables, growth recorded highest mean score (34.69). Follow by firm size (11.92) and board of directors (4.86). The lowest score is recorded by discretionary accrual (−0.36).

Table 1: Descriptive statistics

Variable	Minimum	Maximum	Mean	SD	Observation
Disclosure quality	0.612	0.83	0.723	0.4984	175
Discretionary accrual	−0.998	0.547	−0.356	0.2701	175
Board size of directors	2.00	9.00	4.862	2.0991	175
Board size of commissioners	2.00	8.00	4.171	1.5989	175
Independent commissioners	0.167	1.00	0.390	0.1298	175
Audit committee	3.00	4.00	3.040	0.1965	175
Independent audit committee	1.00	2.00	1.057	0.2327	175
Firm size	4.25	83.00	11.924	14.263	175
Leverage	0.01	10.90	0.697	0.9853	175
Growth	5.00	84.00	34.685	17.568	175

SD: Standard deviation

Table 2: Pearson correlations matrix

Variable	DQ	DACC	BOD	BOC	INDCOM	AC	INDAC	LEV	FSIZE	Growth
DQ	1.00	−0.06	0.01	−0.03	0.01	0.53*	−0.26	0.08	−0.05	−0.04
DACC		1.00	−0.02	−0.01	−0.04	0.11	−0.01	0.03	0.00**	0.03
BOD			1.00	0.00**	0.03	0.08	−0.07	0.02	0.14	0.00**
BOC				1.00	−0.09	0.00**	−0.24	0.17	0.12	0.00**
INDCOM					1.00	−0.06	0.10	0.09	0.02	0.05
AC						1.00	0.54*	−035	0.005	0.39
INDAC							1.00	−041	0.04	−0.56
LEV								1.00	−0.74	−0.72
FSIZE									1.00	0.00**
Growth										1.00

**Correlation is significant at 0.01 levels (two-tailed), *Correlation is significant at 0.05 levels (two-tailed)

4.2. Pearson Correlations

Table 2 presented the Pearson correlation matrix. Consistent with expectation, disclosure quality is negatively associated with discretionary accrual (−0.06). Board size of directors, board size of commissioners and independent commissioners are negatively related to discretionary accrual (−0.02), (−0.01) and (−0.04) respectively. Disclosure quality is positive with Board of Directors size (0.01). Finally, disclosure quality positively associated with audit committee (0.53) and negatively associated with independent audit committee (−0.26). Table 2 Correlation Matrix further confirmed that the data does not suffer from multicollinearity.

4.3. Regression Result

All model are run based on linear regression. For further verification, ordinary least square (OLS) test has been performed.

Model regression results were presented in Panel A as shown in Table 3. Hypotheses on the relationship between corporate governance and discretionary accrual are tested at 0.05 significance level. Corporate governance variables sub-hypotheses H1a, H1b and H1c on board size of directors, board size of commissioners and independent commissioners relationships with Discretionary Accrual are found to be significantly negatively related given their P-value of 0.001, 0.000 and 0.006 respectively. Therefore, the first three sub-hypotheses (H1a, H1b and H1c) supported. However, audit committee and independent audit committee are not significantly related to discretionary accrual as hypothesized. Sub-hypotheses H1d and H1e are not supported. R^2 of 32.5% also indicates the corporate governance variables can significantly predict the level variation in on discretionary accrual. For control variables, leverage and firm size are significant while growth is not significant.

This result is consistent with the previous study by Shen and Chih (2007) that firm with good corporate governance tend to engage less in earnings management as well as that of Findlay (2006) and Chang (2008) which showed that aggregated corporate governance is significantly and positively (negatively) related to earnings management. The insignificant findings of the study on that audit committee and independent audit committee on discretionary accrual (DACC) may be as a result of Indonesia's firm context. This may be because in Indonesia firms are only concerned to meet the requirements of the rule of corporate governance. There is evidence that Indonesian companies with concentrated ownership have conventional corporate governance mechanisms characterized by the limited effectiveness of weak institutions and poor property rights.

Table 3: Panel A: Relationship between corporate governance and discretionary accrual

Equation: $DACC_{i,t}=\alpha_0+\alpha_1 BOD+\alpha_2 BOC+\alpha_3 INDCOM+\alpha_4 AC+\alpha_5 INDAC+\alpha_6 LEV+\alpha_7 FSIZE+\alpha_8 GROWTH+\upsilon$ (6)			
Model	**Beta**	**t-value**	**Significant (P-value)**
Panel A: Dependent variable: DACC (discretionary accrual)			
Constant	−0.044	−2.452	0.004
Board size of director	−0.011	−2.186	0.001
Board size of commissioner	−0.063	−1.718	0.000
Independent commissioner	−0.054	−2.742	0.006
Audit committee	0.063	0.296	0.284
Independent audit committee	0.147	0.461	0.266
Leverage	0.044	1.786	0.020
Firm size	0.006	3.124	0.000
Growth	0.165	0.683	0.496
R^2		32.5	
F		2.969 (0.004)	

Table 4: Panel B: Relationship between corporate governance and disclosure quality

Equation: $DQ_{i,t}=\alpha_0+\alpha_1 BOD+\alpha_2 BOC+\alpha_3 INDCOM+\alpha_4 AC+\alpha_5 INDAC+\alpha_6 LEV+\alpha_7 FSIZE+\alpha_8 GROWTH+\upsilon$ (7)			
Model	**Beta**	**t-value**	**Significant (P-value)**
Panel B: Dependent variable: DQ (disclosure quality)			
Constant	0.048	4.750	0.000
Board size of director	0.058	3.135	0.000
Board size of commissioner	0.164	2.026	0.003
Independent commissioner	0.065	1.275	0.008
Audit committee	0.021	0.783	0.256
Independent audit committee	0.119	0.884	0.372
Leverage	0.035	2.865	0.000
Firm size	0.087	3.165	0.000
Growth	−0.033	0.543	0.358
R^2		27.4	
F		3.347 (0.002)	

Panel B regression results were shown in Table 4. The Table 4 revealed that the level of corporate governance explains 27.4% of the variation in disclosure quality in the model. Corporate

Governance variables of board size of directors, board size of commissioners and independent commissioners as stated in hypotheses (H2a H2b and H2c) are found to be positively and significantly related to disclosure quality based on the P-value of 0.000, 0.003 and 0.008. Depending on the results, the first three hypotheses (H2a H2b and H2c) tested with this model are supported, except for H2d and H2e relating audit committee and independent audit committee to disclosure quality that are not supported. The significant hypotheses are consistent with Amoozesh et al. (2013). However, audit committee and independent audit committee has no significant relationship with disclosure quality. This non-significant finding of audit committee and independent audit committee on disclosure among companies with concentrated ownership on IDX is an indication of the low effectiveness of mechanism of corporate governance. The results of this study can be explained by the documented evidence that Indonesian concentrated companies only comply with corporate governance rules of the regulation, without implementing with effectiveness the corporate governance mechanisms meant to improve disclosure quality.

Table 5 shows the regression results on the relationship between disclosure quality and discretionary accrual based. R^2 of 30.5% indicates that disclosure quality explains for an adequate level of variation on discretionary accrual. The results of the regression test supported the hypothesis of a negative relationship between disclosure quality and discretionary accrual since P = 0.004. Firm size as control variable is significant, but leverage and growth are not. This results consistent with Lobo and Zhou (2001) stated that firms with lower disclosure ratings tend to engage more in earnings management, and firms that engage more in earnings management tend to have lower quality disclosures.

Table 5: Panel C: Relationship between disclosure quality and discretionary accrual

Equation: $DACC_{i,t}=\alpha_0+\alpha_1 DQ+\alpha_6 LEV+\alpha_7 FSIZE+\alpha_8 GROWTH+\upsilon_i$ (8)			
Constanta	**Beta**	**t-value**	**Significant (P-value)**
Panel C: Dependent variable: DA (discretionary accrual)			
Constant	−0.660	−2.260	0.002
DQ	−0.277	−1.865	0.004
LEV	0.041	2.010	0.046
FSIZE	0.005	3.608	0.000
Growth	0.064	0.467	0.632
R^2		30.5	
F		3.347 (0.000)	

Panel D in Table 6 shows the results of the effect of disclosure quality on the relationship between corporate governance and disclosure quality. We investigated the impact disclosure quality as a moderating variable on the relationship between corporate governance and earnings management. Disclosure quality as a moderating variable because there was interaction variable between X_1 (corporate governance) and X_2 (disclosure quality), then these interactions are used as predictors of Y (earnings management). Practically, this means that X_2 (Disclosure Quality) makes a difference regarding how and when X_1 (corporate governance) has an impact on Y (earnings management). Thus, considering moderating variable effects can change the strength and/or direction of a direct relationship. This demonstrated that there is an interaction between X_1 and X_2 in the prediction of Y (see Baron and Kenny, 1986). We decided in this study disclosure quality as a moderating variable.

Prior research showed that relationship between corporate governance and earnings management for emerging market indicate a significant relationship. According to the previous research, better disclosure information is one of the dynamic and essential characteristics and factors in economic decisions (Soheilyfar et al., 2014). Cormier et al. (2012) stated that managers who engage in earnings management are less inclined to be transparent in their disclosure practices and vice versa.

This study we examined the interaction of Disclosure quality with moderated regression analysis (MRA). We examined interaction

Table 6: Panel D: Disclosure quality on the relation between corporate governance and disclosure quality

$DACC_{i,t}=\alpha_0+\alpha_1 DQ+\alpha_2 BOD+\alpha_3 BOC+\alpha_4 INDCOM+\alpha_5 AC+\alpha_6 INDAC+\alpha_7 DQ*BOD+\alpha_8 DQ*BOC+\alpha_9 DQ*INCOM+\alpha_{10} DQ*AC+\alpha_{11} DQ*INDAC+\alpha_{12} LEV+\alpha_{13} FSIZE+\alpha_{14} GROWTH+\upsilon_{it}$ (9)			
Independent variable	**Beta**	**t-value**	**Sig (P-value)**
Panel D: Dependent variable: DA (discretionary accrual)			
Constant	−0.042	−4.541	0.000
Board size of director	−0.087	−1.062	0.001
Board size of commissioner	−0.064	−3.879	0.000
Independent commissioner	−0.045	−1.245	0.004
Audit committee	0.055	0.854	0.449
Independent audit committee	0.182	0.766	0.357
Board size of director*disclosure quality (moderate 1)	−0.064	−2.954	0.001
Board size of commissioner*disclosure quality (moderate 2)	−0.027	−3.065	0.000
Independent commissioner*disclosure quality (moderate 3)	−0.084	−1.877	0.004
Audit committee*disclosure quality (moderate 4)	0.020	−0.547	0.331
Independent audit committee*disclosure quality (moderate 5)	0.649	0.542	0.338
Leverage	0.054	3.309	0.001
Firm size	0.316	2.441	0.000
Growth	−0.623	0.552	0.765
R^2			36.7
F			2.926 (0.003)
No of observations			175

effect for each variable on corporate governance mechanisms. According to Table 6, the interaction effects of disclosure quality with between board size of directors, board size of commissioners, and independent commissioners relationship are negatively significant with discretionary accrual. Based on the results of moderation analysis, disclosure quality has negatively significant interaction on relationships between board size, the board of commissioner, independent commissioner and discretionary accrual. This result indicates that disclosure quality can reduce discretionary accrual when the corporate governance mechanism is effective.

Contrarily, disclosure quality has insignificant interaction on relationships between audit committee, independent audit committee, and discretionary accrual. The finding is consistent with Lobo and Zhou (2001), Francis et al. (2008), Cormier et al. (2012) in complementary relation. The results suggest that manager or majority shareholders who have control of the firm and engage in earnings management are less inclined to be transparent in their disclosure practice and vice versa. However, for audit committee and independent audit committee both are not significantly correlated. The results also give empirical evidence that companies with concentrated ownership in Indonesia have conservative management and are not effectively implementing corporate governance mechanisms.

5. CONCLUSION

This research provided an empirical study on quality disclosure effect on the relationship corporate governance and discretionary accrual as proxy earnings management, from the concentration ownership context. Using 175 sample of listed manufacturing firms on IDX during period 2009-2013, disclosure quality as moderating or interaction variable was investigated with MRA. The results indicated that there is a significant effect on disclosure quality on the relationship between corporate governance mechanism such as board size of directors, board size of commissioners, and Independent commissioners mechanisms and earnings management, This result gave evidence that disclosure quality and good corporate governance can reduce earnings management manipulation on concentration ownership context. This study also found insignificant moderation effect of disclosure quality on the relationship between audit committee and independent audit committee and earnings management variables. This research showed that companies with concentration ownership on IDX only meet requirement regulation of the corporate governance. This meant the existence of weak of corporate governance system which securities regulator have oversight responsibilities on all firm disclosure activities. The stronger corporate governance system and appropriate monitoring have the ability to impact on the firm management to disclosure more and give better financial information. Improved adequate disclosure presents adequate financial reporting as an important way to reduce agency conflict Type 2, which characterized concentrated ownership structures due to conflict of interest between dominant shareholders and minority shareholders.

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