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Differences in the influence of the board of directors and the board of commissioners on real earnings management: empirical evidence from Indonesia

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Abstract

Purpose – This research investigates the influence of the Board of Directors (BOD) and the Board of Commissioners (BOC) on real earnings management (REM) practices in Indonesian manufacturing companies. Real earnings management involves genuine alterations to operational decisions that affect financial reporting.

Design/methodology/approach – The research uses a sample of manufacturing firm listed on Indonesia Stock Exchange (BEI) from 2016 to 2022 and uses panel data regression techniques, including the Pooled Least Square (PLS) and Fixed Effect Model (FEM), to examine the effects of BOD and BOC characteristics on REM. The empirical analysis considers multiple proxies for BOD and BOC attributes, such as board size, independence, meeting frequency, and expertise. Additionally, control variables including leverage, firm size, and growth indicators are incorporated into the analysis.

Findings – The findings reveal a significant positive relationship between the presence of BOD and REM activities. In contrast, the presence of BOC demonstrates a non-significant but negatively associated impact on REM. Furthermore, the research identifies the moderating role of BOC in strengthening the relationship between BOD and REM.

Research limitations/implications – The research contributes to the existing literature by providing empirical insights into the roles of BOD and BOC in shaping REM practices within the Indonesian manufacturing context. These findings highlight the importance of board characteristics in influencing financial reporting decisions and emphasize the need for effective corporate governance mechanisms to mitigate opportunistic behaviors related to earnings management.

Practical implications – Enhancing corporate governance practices, provide an input for more effective board composition, increase the investor confidence and transparency, enhance policy implications and provide advice for company's long-term performance focus.

Originality/value – This research addresses a gap in the literature by focusing on the Indonesian context. Use the BOC to moderate the relationship between BOD and REM may be less common in the context of Indonesia and even in regional focus.

Keywords: Real earnings management, board of directors, board of commissioners, corporate governance.

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Introduction

Indonesia adopts a two-tier system in the corporate governance mechanism. The two-tier system allows for differentiation in functions and responsibilities between the Board of Commissioners and the Board of Directors within a company. The Board of Commissioners is tasked with supervising the processes and outcomes of the Board of Directors' work (Darmadi, 2013; Ooi et al., 2021). Hence, it's not surprising that the position of the Board of Commissioners is one level above the position of the Board of Directors in the company's organizational chart. (Tian, 2009). It is important to emphasize that in countries (typically Anglo-Saxon countries) where companies adopt the one-tier system, they also have both supervisory and management functions. The supervisory function is usually carried out by non-executive directors, while the management function is performed by executive directors (Goergen & Renneboog, 2014). There is no empirical evidence yet that can explain whether the one-tier corporate governance system is better than the two-tier system, or vice versa. There is no one-size-fits-all ideal corporate governance that can be adopted by all companies in all countries. Even the corporate governance mechanisms that are applied and considered suitable in advanced countries may not necessarily have the same impact when implemented in developing countries (Black et al., 2012).

The existence of corporate governance mechanisms today is an absolute requirement for an organization to build investor confidence and ensure fair treatment of all stakeholders. A sound corporate governance system provides effective protection for shareholders to recover investments in a reasonable, correct, and efficient manner, and also ensures that company management acts in the best interests of the company (Mahrani & Soewarno, 2018). With their oversight authority, the Board of Commissioners must be capable of contributing to the business strategy determination process. It is not uncommon for the chairman and members of the Board of Commissioners to be expected to contribute ideas or provide opinions to the Board of Directors regarding strategic decisions of the company. The Board of Commissioners is also obligated to ensure that the supervised company has appropriate internal controls. Additionally, the Board of Commissioners is expected to alert and prevent the Board of Directors from making aggressive business decisions that are deemed to carry significant business risks for the company. The Board of Commissioners also has the right to appoint members of the Board of Directors, determine the remuneration of Board of Directors members, and hold significant control over the decision-making processes within the scope of investments and finances (Tian, 2009).

Both the Board of Commissioners and the Board of Directors will collaborate in efforts to enhance the company's performance and value. Investors diligently evaluate a company's performance through financial reports regularly published by the company's management. Financial reports contain essential information relied on by investors in their attempt to predict the potential growth of the company in the future. While not the sole determinant of a company's stock price movement, the published financial reports will also influence decisions to buy or sell shares in the capital market. The market will react positively if the company manages to achieve profit performance as expected (Ge & Kim, 2014). If investors assess a company's performance reflected through the figures in the financial reports that do not meet the expected consensus, they are inclined to divest or sell their ownership in that company. And when many investors act similarly, this will lead to a decline in the stock price, which is clearly not favorable for the company. Therefore, companies are essentially "pressured" to publish financial reports that align with market expectations to avoid a drop in stock price after the reports are released. This indirectly contributes to an increase in earnings management activities within a company.

Earnings management is the decision to achieve specific objectives regarding financial statement outcomes using accounting methods or by directly influencing operational activities (Cupertino et al., 2015). Corporate management, in this case the members of the Board of Directors (with the approval of the Board of Commissioners), is motivated to engage in earnings management with the aim of generating financial statements that align with market expectations. Cai et al. (2018) investigated Chinese companies and concluded that the motivation for engaging in earnings management becomes stronger when companies face significant external pressure after reporting business losses. Earnings management practices can vary widely and may involve income smoothing, income maximization, income minimization, and also a practice known as "taking a bath" (Scott, 2009). Whatever approach is taken, earnings management is a form of intervention carried out by company management to oversee the company's profit fluctuations from one period to another. Many companies prioritize publishing profit figures that are not too volatile but must align with the consensus among capital market investors. It should be emphasized that the Board of Directors and the Board of Commissioners cannot be entirely free to engage in earnings management practices. The research by Miller et al. (2021) demonstrates that the presence of institutional investors with sufficient expertise and business experience has been proven to reduce earnings management activities.

In this regard, both the Board of Directors and the Board of Commissioners contribute to the company's earnings management decisions. Because the Board of Directors and the Board of Commissioners have their respective functions and responsibilities, will the Board of Directors be more involved in earnings management decisions compared to the Board of Commissioners? Or is it instead the Board of Commissioners that plays a greater role in determining the company's earnings management strategy? Previous studies such as (Alkebsee et al., 2022; Harymawan et al., 2022; Luo et al., 2017; Mather & Ramsay, 2006) have considered the Board of Directors, especially the CEO, to be primarily responsible for company earnings management activities. This is because the Board of Directors itself comprises executive directors who can be directly involved in strategic account "manipulation", such as increasing receivables and revenue, reducing costs, and applying more aggressive accounting policies to "create" the expected profit targets. Many earlier studies also perceive the roles of the Board of Directors and the Board of Commissioners as equally crucial in determining earnings management activities. The Board of Directors and the Board of Commissioners will share responsibilities. In this context, the Board of Directors is the entity that "performs," while the Board of Commissioners is the entity that "approves". Hence, many studies feel that there is no need to specifically differentiate variables related to corporate governance components concerning the measurement of corporate governance mechanisms (Hutchinson et al., 2008; Sehrawat et al., 2019; Suyono & Al Farooquee, 2018).

This research aims to clearly distinguish the roles of the Board of Directors and the Board of Commissioners in the effort to conduct earnings management. Although both functions share the same goal of enhancing the company's value, the significance of the contribution of each function to earnings management activities will be analyzed and studied. This research also seeks to empirically demonstrate whether the presence of the Board of Commissioners strengthens or weakens the influence of the Board of Directors on corporate earnings management. The research focuses on the manufacturing sector of companies listed on the Indonesia Stock Exchange (IDX) from 2016 to 2022. Out of the total 743 companies listed on the IDX from 2016 to 2022, there are more than 20% manufacturing companies spread across various sectors such as the basic and chemical industry sector, miscellaneous industry sector, consumer goods sector, and various sub-sectors within them (Indonesia Stock Exchange, 2024). According to the Siahaan (2024), the manufacturing sector contributes approximately 18.67% to Indonesia's total GDP of the year 2023 and is the most dominant sector in its contribution to the national economy. Research focused on the manufacturing sector will provide significant insights into Indonesia's overall economic performance.

This research is expected to make an academic contribution by adding literature on the differences in the roles of the Board of Directors (BOD) and the Board of Commissioners (BOC) in influencing real earnings management practices. Additionally, this study is also expected to provide practical contributions in the form of recommendations and comparative analysis results that can be used as considerations in making strategic decisions oriented towards the long-term performance of companies.

Literature Review and Hypotheses

Stakeholder Theory

Stakeholder theory assumes that a company's actions should meet the expectations of its stakeholders. The establishment of an organization aims to fulfill the interests of stakeholders, not solely to pursue profit attainment (Lange & Bundy, 2018). One of the most influential stakeholders for a company is its shareholders, who act as investors in the company. The investor's purpose for investing in a company is to gain a return from it. The sources of income for investors include dividends and capital gains. To provide shareholders with the opportunity for optimal capital gains, company management is expected to consistently achieve good performance over time, preventing a decline in stock prices. It should be emphasized that stakeholder theory doesn't solely focus on meeting the expectations of shareholders. The needs of other stakeholders must also be fulfilled.

The research by Chakraborty & Biswas (2020) demonstrates that proper human resource management activities, such as improving recruitment systems, employee training and development, and effective succession planning, will have a positive impact on the sustainable performance of a company. Other stakeholders, such as customers, also play a crucial role in a company's success. Customer lifetime value has been shown to be a more significant performance indicator for a company compared to customer loyalty (Smith & Chang, 2009). This implies that company management must ensure that customer interests are met to maintain long-term performance stability.

Relate to research topic, the stakeholder theory itself provides a theoretical framework for understanding how corporate governance practices influence accrual or real earnings management initiatives by considering the interests and expectations of various stakeholders. Effective corporate governance mechanisms through the significant roles of Board of Directors (BOD) and Board of Commissioners (BOC) that align with stakeholder interests can discourage excessive earnings management practices and promote long-term value creation for companies by fostering trust, transparency, and integrity in financial reporting and decision-making processes.

Earnings Management

A company is said to engage in earnings management when managers use judgment in the process of preparing financial statements and then restructure transactions that lead to changes in the underlying economic performance, ultimately misleading the assessment of certain stakeholders (Healy & Wahlen, 1999). This implies that earnings management actions will degrade the quality of financial reporting (Ascioglu et al., 2012).

Universal earnings management is divided into two types: accrual-based earnings management and real earnings management (Cupertino et al., 2015). Accrual-based earnings management is carried out through the use of managerial judgment in the financial reporting process, resulting in changes to accrual levels and earnings as a consequence. On the other hand, real earnings management involves manipulating the level of cash flows by deviating from normal business practices (such as operational, investment, and financing transactions) and ultimately altering earnings towards the expected direction (Roychowdhury, 2006). According to Abshari & Rahman (2020), real earnings management adds complexity for readers in analyzing the annual reports issued by companies. Managers typically choose one earnings management practice that suits their company's condition. There are also companies that simultaneously practice both accrual-based and real earnings management. This is particularly feasible for companies located in countries with less stringent government regulations (Hamza & Kortas, 2018).

Hypothesis Development

Board of Director's Role on Earnings Management

The role of the Board of Directors (BOD) is crucial for a company. In the case of Indonesian companies, the BOD refers to the Board of Directors, which consists of directors specialized in their respective fields, led by a President Director/CEO (Chief Executive Officer). The Board of Directors plays a significant role as the steering function that guides the company's direction. In this context, decisions and the determination of the company's strategy are made by the Board of Directors. The research conducted by Plöckinger et al. (2016) indicates that top management executives play a crucial role in financial reporting decisions, particularly in terms of the quality of disclosures closely related to real earnings management practices. Weber (2006) conducted research and concluded a positive influence of CEO wealth sensitivity on real earnings management practices. The research results also indicate that corporate governance is not significant in influencing the relationship between CEO wealth-based stock value and income smoothing. It indicates that a low proportion of non-executive directors in the board composition will increase earnings manipulation activities, especially in relation to events like rights issues carried out by companies in the UK. The research conducted by Gavious et al. (2012) indicates that if the CEO or CFO is a woman, real earnings management activities are likely to decrease. The findings of this study are consistent with similar research conducted by (Mnif & Cherif, 2020; Peni & Vähämaa, 2010). This implies that the presence of female directors in the Board of Directors will enhance the quality of financial reporting. The study also examined the influence of variables related to the attributes of the Board of Directors (BOD) such as work scope, independence, and competence of the Board of Directors on real earnings management practices. The empirical findings also reveal that the presence of directors holding director positions simultaneously in multiple companies has a significant positive impact on real earnings management but is not significant in affecting accrual-based earnings management practices (Baatour, Othman & Hussainey, 2017). Another aspect of corporate governance, such as CEO stock ownership, has been proven to not have a significant connection to audit fee decisions, which are believed to be closely related to the quality of financial reporting (Salehi et al., 2018). Guangguo et al. (2019) examined the role of dominant shareholders appointing executive directors to the Board of Directors (BOD) in Chinese companies. The research findings show that executive directors appointed by majority shareholders have been found to reduce earnings management levels and increase the sensitivity of the higher pay-performance system. Companies whose CEOs possess financial and accounting expertise have been proven to engage in more earnings management practices because these top executives understand the tactics that can be employed in financial reporting interventions (Ngo & Nguyen, 2024).

Despite some positive and negatives relationship described above, the presence of the Board of Directors (BOD) may increase real earnings management practices under some circumstances. Too many members on the Board of Directors (BOD) structure may lead to an issue of conflict of interest. In some cases, some directors may have personal relationships and different purposes with the other directors and unfortunately could compromise their independence and objectivity. This can create opportunities for the decision maker to engage in aggressive real earnings management practices. The Board of Directors (BOD) may also face pressure from shareholders, analysts, or other stakeholders to meet financial targets or expectations. In response, they may turn a blind eye to aggressive accounting practices that temporarily boost reported earnings to meet these expectations. In summary, while the Boards of Directors (BOD) are generally expected to promote transparency and integrity in financial reporting, various factors can contribute to their ineffectiveness or even complicity in increasing real earnings management practices.

H_1: The board of directors (BOD) has a significant positive influence on real earnings management.

Board of Commissioner's Role on Earnings Management

The Board of Commissioners (BOC) has the responsibility to supervise the decision-making process of the Board of Directors (BOD). In the case of Indonesian companies, the BOC comprises a set of components within the Board of Commissioners, consisting of director members overseeing the remuneration committee, audit committee, nomination committee, and risk committee, led by a Chairman of the Board of Commissioners. Companies with annual board membership selection, a reasonably sized board, and 100% independent director members in the nomination and remuneration committees have been proven to reduce earnings management activities (Epps & Ismail, 2009).

The enactment of The Sarbanes-Oxley Act (SOX) in 2002, following the emergence of financial reporting scandals involving several major companies worldwide such as Enron and Worldcom, marked a new era in corporate governance mechanisms (Kenton, 2024). Chang & Sun (2010) found in their study that an all-independent audit committee and a board composition dominated by independent directors complement each other in efforts to enhance the quality of financial reporting, especially after the implementation of SOX in 2002. The research by Campa & Donnelly (2014) which employed various proxies for the Board of Commissioners (BOC) such as audit quality, expertise and independence of the audit committee, and non-executive directors, demonstrated that corporate governance reforms in Italy have proven to be more significantly influential in affecting real earnings management. Al-Thuneibat et al. (2016) examined the role of internal audit attributes and the audit committee in real earnings management. The research findings indicate that the scope and independence of internal audit, as well as the independence of the audit committee, are negatively related to real earnings management. However, the competence of internal audit, the scope of work of the audit committee, and the competence of the audit committee do not have a significant impact in mitigating real earnings management practices. The presence of the Board of Commissioners (BOC) role, as indicated by board size proxy, board independence, the number of audit committee meetings, and director remuneration, has been found to have a highly significant relationship in determining the extent of earnings management practices in commercial banks in India (Kumari & Pattanayak, 2017). Similar research was conducted in Portugal and demonstrated that board size and board composition influence earnings management, but the presence of an audit committee is not significant in affecting earnings management activities (Alves, 2011). Research conducted in Malaysia also did not find a significant relationship between the presence of an independent audit committee and the level of earnings management (Mohammad & Wasiuzzaman, 2020).

H_2: The Board of Commissioners (BOC) has a significant negative influence on real earnings management.

All significant decisions made by the Board of Directors should ideally receive approval from the Board of Commissioners, which is responsible for overseeing the process and performance of the Board of Directors. Regarding earnings management, the Board of Commissioners should play a crucial role in mitigating earnings management decisions made by the Board of Directors. Imen & Anis (2021) demonstrated in their research that the variable of audit quality can moderate the influence of audit opinion on earnings management. Modified audit opinions were found to increase earnings management practices in Tunisian companies. Audit quality is the responsibility of the Audit Committee, which operates under the framework of the Board of Commissioners.

H_3: The Board of Commissioners (BOC) has the ability to moderate the influence of the Board of Directors (BOD) on real earnings management.

Research Methods

The data collection technique in this study is classified as quantitative research. The financial reports of companies listed on the Indonesia Stock Exchange (IDX) are used as the population for this research. The sample used consists of financial reports of manufacturing companies listed on the IDX from 2016 to 2022, taking into account the completeness of annual report data. The research sample was selected using purposive sampling method, where the sample is randomly chosen while considering several factors (Indriantoro & Supomo, 2018). Some criteria in the selection of research samples include:

- Manufacturing companies listed on the Indonesia Stock Exchange (BEI) from 2016 to 2022;
- Manufacturing companies that have issued annual reports and financial statements from 2016 to 2022, which have been audited by independent auditors during the respective periods; and
- The required data for the research variables are presented in the respective reports.

Operational Definition of Variables and Measurement

The variable that will be used as the dependent variable in this study is earnings management. According to Bajra & Cadez (2018), earnings management is a managerial activity involving the manipulation of reported earnings according to desires by influencing the financial reporting process. This study opts for a measurement of earnings management based on real activities, commonly referred to as real earnings management, as opposed to accrual-based earnings management. Accrual-based earnings management only alters the timing of revenue without changing the total cash flow amount, thus not significantly affecting the fundamental performance of the company (Graham, Harvey & Rajgopal, 2005). Conversely, real earnings management involves altering actual decisions made by company managers, such as cutting research and development costs or substantial advertising expenses, which can lead to a decline in the long-term performance of the company (Cai et al., 2018).

The model for calculating real earnings management used in this study is a formula based on previous research from (Roychowdhury, 2006). One of the models used is a calculation model using abnormal cash flow from operations. Management can temporarily boost company sales within a period through regular operational decisions, such as offering sales discounts or enticing customers by extending the payment period for receivables. Although it can be considered a strategic move, the sales generated may not reflect the company's sustainability in carrying out its operational activities. A large sales volume through such methods tends to result in lower incoming cash flows compared to the cash flows from normal sales. Hence, observing the abnormal cash flow values from operations in a company can help detect the presence of earnings management activities within the company (Sitanggang et al., 2020). The following is an elaboration of the calculation model for real earnings management based on actual activities to determine the normal level of cash flow from operations:

$$\frac{CFO_t}{TA_{t-1}} = \alpha_0 + \alpha_1\left[\frac{1}{TA_{t-1}}\right] + \beta_1\left[\frac{S_t}{TA_{t-1}}\right] + \beta_2\left[\frac{\Delta S_t}{TA_{t-1}}\right] + \varepsilon \quad (1)$$

The next calculation model involves estimating the abnormal cash flow from operations. This value can be obtained by finding the difference between the normal value of operating cash flow and its actual value. This estimation can also be detailed using the following model:

$$ACFO_1 = \frac{CFO_t}{TA_{t-1}} - \left[\alpha_1\frac{1}{TA_{t-1}} + \beta_1\frac{S_t}{TA_{t-1}} + \beta_2\frac{\Delta S_t}{TA_{t-1}}\right] \quad (2)$$

The second calculation model for the real earnings management variable in this study involves abnormal discretionary expenses, as formulated by (Roychowdhury, 2006). Discretionary expenses within a company refer to the total amount of selling, general, and administrative costs incurred during a specific period. These expenses can be managed and reduced to enhance current-year earnings. Companies that opportunistically and aggressively trim their discretionary costs may show lower and unusual expense amounts (Sun et al., 2014). The following is the calculation model to determine the estimated value of normal discretionary expenses:

$$\frac{DISX_t}{TA_{t-1}} = \alpha_0 + \alpha_1\left[\frac{1}{TA_{t-1}}\right] + \beta_1\left[\frac{S_{t-1}}{TA_{t-1}}\right] + \varepsilon \quad (3)$$

The estimation of abnormal value for discretionary expenses will be conducted after determining the normal level. This value can be obtained by calculating the difference between the normal discretionary expenses and the actual value. The estimation is demonstrated by the following calculation model:

$$ADISX_t = \frac{DISEXP_t}{TA_{t-1}} - \left[\alpha_1\frac{1}{TA_{t-1}} + \beta_1\frac{S_{t-1}}{TA_{t-1}}\right] \quad (4)$$

The third proxy used to measure real earnings management in this study is abnormal production cost. This proxy is also one of the three proxies formulated by (Roychowdhury, 2006). Increasing the production volume in a certain period can reduce the company's fixed production costs, leading the company to have a low cost of goods sold and a high profit margin in that period. The following is an estimation of the calculation model for the normal level of production cost:

$$\frac{PROD_t}{TA_{t-1}} = \alpha_0 + \alpha_1\left[\frac{1}{TA_{t-1}}\right] + \beta_1\left[\frac{S_t}{TA_{t-1}}\right] + \beta_2\left[\frac{\Delta S_t}{TA_{t-1}}\right] + \beta_3\left[\frac{\Delta S_{t-1}}{TA_{t-1}}\right] + \varepsilon \quad (5)$$

The estimation of abnormal value from production costs will be conducted after determining the value at the normal level. This value can be obtained by calculating the difference between the normal value and the actual value. The estimation of this abnormal value is shown through the following calculation model:

$$APROD_t = \frac{PROD_t}{TA_{t-1}} - \left[\alpha_1 \frac{1}{TA_{t-1}} + \beta_1 \frac{S_t}{TA_{t-1}} + \beta_2 \frac{\Delta S_t}{TA_{t-1}} + \beta_3 \frac{\Delta S_{t-1}}{TA_{t-1}}\right] \quad (6)$$

These three proxies are used to measure the variable of real earnings management, which is the dependent variable of this study. All proxies are based on Roychowdhury (2006) research on manufacturing companies in the United Kingdom. The three proxies for measurement are simultaneously assessed and then combined into a unified model for measuring real earnings management based on actual activities:

$$REM_t = APROD_t - ACFO_t - ADISX_t \quad (7)$$

Here's a further explanation of the formula components mentioned above:

REM_t Real earnings management in year t
CFO_t Cash flow from operations in year t
$DISEXP_t$ Total selling, general and administrative expenses in year t
$PROD_t$ *Cost of goods sold* in year t plus ΔINV_t
ΔINV_t Change in inventory from year t-1 to t
TA_{t-1} Total aset in year t-1
S_t Sales in year t
ΔS_t Change in sales from year t-1 to t
ΔS_{t-1} Change in sales from year t-2 to t-1
ε *Error* in year t

The following are the operational definitions of the independent and control variables used in the study. The measurement formulas for these variables, as described below, are drawn from various sources such as (Chandra & Djashan, 2018; Cherif et al., 2020; Ebaid, 2013; González & García-Meca, 2014; Mardianto Mardianto & Carin, 2021; Rajeevan & Ajward, 2019; Sharma & Kuang, 2014; Sufiana & Karina, 2020; Swastika, 2013).

Table 1. Operational Definitions and Variables Measurement

Variables Name	Proxy	Operational Variable	Measurement
Independent Variables			
Board of Director (BOD)	BOD Size	The number of BOD members in a company.	(The number of BOD members/The average number of BOD members) + (The number of independent directors/The average number of independent directors) + (The number of BOD meetings/The average number of BOD meetings) + (The number of BOD members with expertise in accounting and finance/The average number of BOD members with expertise in accounting and finance)
	BOD Independence	Referring to non-executive directors in the company's BOD structure.	
	BOD Meeting	The activities of the BOD measured by the number of meetings attended by the members of the company's BOD.	
	BOD Expertise	Board members with expertise in accounting and finance.	
Board of Commissioner (BOC)	Audit Committee Size	Referring to the number of members in Audit Committee under the auspices of the BOC.	(The number of Audit Committee members/The average number of Audit Committee members) + (The number of independent Audit Committee members/The average number of
	Audit Committee Independence	Independent members of the Audit Committee who meet the specified criteria, such as	

Variables Name	Proxy	Operational Variable	Measurement
		not being employees, business associates, or family relations.	independent Audit Committee members) + (The number of
	Audit Committee Meetings	The number of meetings held by the Audit Committee members to discuss the tasks of the Audit Committee.	meetings attended by Audit Committee members/The average number of meetings attended by Audit Committee members) + (The number of
	Audit Committee Expertise	Members of the Audit Committee with expertise in accounting and finance.	Audit Committee members with expertise in accounting and finance/The average number of Audit Committee members with expertise in accounting and finance)
Control variables			
Leverage (LEV)		Debt-to-Total Assets or Debt-to-Equity Ratio of the company.	Total debt / Total assets
Firm Size (FS)		Company scale reflected by asset value, sales and market value.	Natural logarithm of sales value
Growth (GRW)		The growth rate of company assets or sales value from year to year.	(Sales in year t – sales in year t-1) / Sales in year t-1

Previous research that included the corporate governance variable tended to describe the measurement proxies of corporate governance independently. This study attempts to create composite variables by combining four proxies to measure the Board of Directors (BOD) and four proxies to measure the Board of Commissioners (BOC). Some criteria need to be determined before deciding what proxies should be combined. The combined proxies need to be related to the same underlying construct or concept and have a similar way in terms of data gathering. Combining proxies into a composite variable allows us to simplify the analysis and more focus on our main variables like BOC and BOD by reducing the number of variables to be considered. Based on our knowledge so far, there hasn't been any research that combines measurement proxies of corporate governance like we have done above.

This research uses SPSS and EViews software for data processing. Data processing aims to test the research hypotheses. Hypothesis testing is conducted using panel regression. Before conducting panel regression, this study needs to select the most suitable model in the panel regression technique. Chow test and Hausman test are used to determine whether Pooled Least Square (PLS), Fixed Effect Model (FEM), or Random Effect Model (REM) is the most suitable to be used. Descriptive statistical tests, outlier tests, and classical assumption tests will be initially processed using the SPSS application. On the other hand, the Chow test, Hausman test, F-test, and t-test will be conducted using the Eviews software. This research will return to using the SPSS application to test the moderating effect of the Board of Commissioners (BOC) variable in strengthening/weakening the influence of the Board of Directors (BOD) on real earnings management.

Results and Discussion

This research uses secondary data with a sample selection of financial statements data from manufacturing companies listed on the Indonesia Stock Exchange (BEI) during the period from 2016 to 2022. Based on the collected sample data, there are 743 companies listed on BEI. Out of these 743 companies, only 148 companies meet the sample selection criteria. A total of 595 companies do not meet the sample selection criteria either because they are not engaged in the manufacturing sector or they have incomplete research data, thus they are excluded from the observation data. The summary of population data and sample data is presented in the table below.

Table 2. Summary of Sample Selection Process

Description	Figures
Companies registered in BEI from 2016-2022	743 companies
Companies that did not meet the research criteria	(595) companies
Companies included in the final data sample	148 companies
Research year (2016 to 2022)	5 years
The initial number of data targeted for observation	740 data
The number of outlier data	(125) data
Final observation firm-year observations	615 data

The table below shows the results of descriptive statistical tests.

Table 3. Descriptive Statistical Test Result

Variables	N	Minimum	Maximum	Average	SD
REM	615	-1.87414	0.91313	-0.00087	0.36057
-AB_CFO	615	-0.34462	0.50917	0.00001	0.09883
-AB_PROD	615	-0.99620	0.97323	-0.00088	0.19196
-AB_DISC	615	-0.32488	0.60990	-0.00001	0.12839
BOD	615	1.14108	9.23710	4.11322	1.53491
BOC	615	0.00000	12.05325	3.31430	1.08245
LEV	615	0.06653	5.16774	0.53150	0.49919
FS (Rp Billions)	615	56.61937	239,205	9,728.672	1.62031
GRW	615	-0.79007	3.78621	0.03856	0.29707

The above statistical test results show an average REM value of -0.00087. This indicates that the manufacturing companies listed on the Indonesia Stock Exchange (BEI), which were observed during the period 2016-2022, are not indicated to be engaged in real earnings management activities. The elaboration of the REM data above, which shows an average abnormal cash flow (AB_CFO) of 0.00001, abnormal production (AB_PROD) of -0.00088, and abnormal discretionary expenses (AB_DISC) of -0.00001, indicates that the observed companies engage in real earnings management activities in the operating cash flow section, but at a very small scale. There is no indication of real earnings management activities in the production and discretionary expenses sections. Furthermore, the average value of BOD is 4.11322, which is higher than the average value of BOC at 3.31430. This indicates that the average board of directors' size, independent board of directors' size, board of directors' meetings, and board of directors' expertise have a larger proportional relationship compared to the average size of the audit committee, independent audit committee size, audit committee meetings, and audit committee expertise. The control variable in this study is leverage, with an average value of 0.53150, indicating that the observed companies have an average debt-to-asset ratio of 53%. The descriptive statistical test results also show that the observed companies have an average sales value of IDR 9 trillion and an average sales growth rate of 3.86%.

Panel Data Regression

The selection of an appropriate model in panel data regression technique is essential before conducting hypothesis testing. This study performs the Chow test and the Hausman test to determine the suitable model. According to Ghozali (2013), potential outcomes of panel regression include Pooled Least Square (PLS), Fixed Effect Model (FEM), or Random Effect Model (REM).

Chow Test Results

The Chow test is conducted to determine whether the PLS or FEM model is suitable for the panel regression technique. If the cross-section Chi-Square value in the Chow test shows a probability value < 0.05, then the FEM model will be chosen. Conversely, if the probability value on the cross-section Chi-Square is greater than 0.05, then the PLS model is considered to be the appropriate model (Ghozali, 2013). The table below shows the Chow test results with a probability value of

0.0000. This indicates that the FEM model is selected as the best model, and the next step is to proceed with the Hausman test.

Table 4. Chow Test Result

Description	Stat Value	Prob.	Conclusion
Cross-section Chi-Square	388.92534	0.0000	FEM

Hausman Test Result

The Hausman test is conducted to determine the best model between FEM and REM in the panel regression technique. If the cross-section Chi-Square value in the Hausman test shows a probability value < 0.05, then the FEM model will be selected. Conversely, if the probability value on the cross-section Chi-Square is greater than 0.05, then the REM model is considered to be the appropriate model (Ghozali, 2013). The table of the Hausman test results below indicates a probability value of 0.0004, which means that the FEM model is selected as the best model in the panel regression technique.

Table 5. Hausman Test Result

Description	Chi-Sq. Stat	Prob.	Conclusion
Cross-section Random	31.3433	0.0004	FEM

The F-Test Result

The F-test is conducted to determine whether all independent variables and control variables collectively affect the dependent variable simultaneously or not (Ghozali, 2013). The table below indicates significance values below 0.05, which means that all independent and control variables collectively have a simultaneous effect on real earnings management.

Table 6. The F-Test Result

Dependent Variable	F-Test	Sig. Value
REM	Prob (F-Stat.)	0.0000

The T-test Result

The T-test is conducted to determine the influence or significance of each independent variable on the dependent variable in the research. The significance criterion is determined by the probability value of each independent variable in the t-test results. If the probability value is below 0.05, then the independent variable is considered to have a significant influence on the dependent variable. Conversely, if the probability value is above 0.05, it is concluded that the independent variable does not have a significant influence on the dependent variable. The coefficient values in the t-test results also indicate the positive and negative direction of the relationship between the independent variable and the dependent variable in the research (Ghozali, 2013).

Table 7. The T-Test Result

Variables	Coefficient Value	Prob. Value	Conclusion	Hypotheses
Constant	0.3244321			
BOD	0.0017192	0.0467	+ Sig.	H1 Supported
BOC	-0.0132160	0.2087	Non-Sig.	H2 Not Supported
LEV	0.0067280	0.0076		
FS	-0.0443312	0.0331		
GRW	-0.0498776	0.0001		

Based on the panel regression results and information from Table 7, the regression model equation obtained to test the H_1, H_2 and control variables is as follows:

$$REM = 0.3244 + 0.0017BOD - 0.0132BOC + 0.0067LEV - 0.0443FS - 0.0499GRW + \varepsilon$$

Table 8. The T-Test Result

Variables	Coefficient Value	Prob. Value	Conclusion	Hypotheses
Constant	0.3155861			
BOD	0.0017928	0.0468	+ Sig.	H1 Supported
BOC	-0.0130885	0.2075	Non-Sig.	H2 Not Supported
BOD*BOC	0.0006781	0.0488	+ Sig.	H3 Supported
LEV	0.0079210	0.0077		
FS	-0.0468822	0.0325		
GRW	-0.0446516	0.0001		

Based on the panel regression results and information from Table 8, the regression model equation obtained to test the H_3 is as follows:

$$REM = 0.3156 + 0.0018BOD - 0.0131BOC + 0.0007BOD*BOC + 0.0079LEV - 0.0469FS - 0.0447GRW + \varepsilon$$

The Discussion of The Impact of The BOD on Real Earnings Management

Information from Table 7 shows the BOD's prob value is 0.0467. The presence of the Board of Directors (BOD) has been found to have a significant positive impact on real earnings management. The results of this test are consistent with the first hypothesis proposed in this study. A higher average size of the board of directors, independence of the board of directors, the number of board meetings, and expertise of the board of directors have been shown to increase the level of real earnings management activities. The findings of this research are consistent with previous studies conducted by (Al-Thuneibat et al., 2016; Ngo & Nguyen, 2024; Plöckinger et al., 2016).

The Discussion of The Impact of The BOC on Real Earnings Management

Information from Table 7 shows the BOC's prob value is 0.2087. The presence of the Board of Commissioners (BOC) has been found to have a not significant but negative relationship with real earnings management. The results of this test deviate from the second hypothesis proposed in this study. Furthermore, the test results indicate that the proportional average size of the audit committee, independent audit committee, the number of audit committee meetings, and the expertise of the audit committee do not significantly influence real earnings management activities but have a negative relationship. This implies that a larger proportional presence of the Board of Commissioners (BOC) may slightly reduce the practice of real earnings management, but the effect is minimal and not statistically significant. These findings are consistent with tests conducted by (Alves, 2011; Kolsi & Grassa, 2017; Mohammad & Wasiuzzaman, 2020; Sahyoun & Magnan, 2020; Sun et al., 2014).

Table 9. Adjusted R^2 Test Result – Without Moderation of BOC

Predictors	R	R^2	Adjusted R^2	Standard Error of the Estimate
Constant BOD	0.162	0.026	0.025	0.3561139

Table 10. Adjusted R^2 Test Result – With Moderation of BOC

Predictors	R	R^2	Adjusted R^2	Standard Error of the Estimate
Constant BOD BOC BOD*BOC	0.181	0.033	0.028	0.3554971

Discussion of the Moderating Effect of the BOC on the Relationship Between the BOD and Real Earnings Management

The variable of the Board of Commissioners (BOC) has been found to positively moderate the influence of the Board of Directors (BOD) on real earnings management practices. As seen from the results presented in Table 8, which shows the BOD*BOC's prob value of 0.0488, it is evident that the BOC variable strengthens the significant effect of the BOD on real earnings management. Comparison between Table 9 and 10 also shows the R^2 value increases after incorporating the BOC variable as a moderating effect in the study. These testing results are unexpected and contrary to expectations. The presence of the BOC was anticipated to mitigate or weaken the influence of the BOD in engaging in earnings management. This finding contradicts the study conducted by (Imen & Anis, 2021).

Theoretical Implication and Managerial Implication

The research contributes to the existing literature by providing empirical insights into the roles of BOD and BOC in shaping REM practices within the Indonesian manufacturing context. These findings highlight the importance of board characteristics in influencing financial reporting decisions and emphasize the need for effective corporate governance mechanisms to mitigate opportunistic behaviors related to earnings management. Some practical implications that this research could provide are:

(1) Enhancing corporate governance practice - The research underscores the significance of robust corporate governance practices, particularly in the composition and roles of the Board of Directors and Board of Commissioners. Companies can benefit by structuring their boards to include a mix of expertise, independence, and regular interaction to effectively monitor and mitigate opportunistic real earnings management activities; (2) effective board composition - Organizations can consider optimizing the size and composition of their boards to achieve a balance between monitoring and decision-making. A larger board size with independent and knowledgeable members can help enhance oversight and contribute to more accurate financial reporting; (3) strategic decision making - Executives and board members can leverage the findings to make informed decisions about financial reporting practices. The study highlights the importance of genuine operational decisions over earnings manipulation, encouraging companies to focus on sustainable growth strategies rather than short-term profit maximization; (4) investor confidence and transparency - Transparent financial reporting practices can foster investor confidence and attract potential stakeholders. Companies that prioritize ethical financial reporting are likely to be perceived positively by investors, leading to improved capital inflow and reduced information asymmetry; (5) policy implications - Regulatory bodies and policymakers can consider incorporating the research's findings into corporate governance guidelines. This may lead to more specific recommendations on board composition, independence, and expertise requirements, contributing to the overall integrity of financial reporting practices; (6) educational initiatives - The research outcomes can inform educational programs for board members, executives, and professionals in the finance and accounting fields. By promoting awareness about the implications of board characteristics on real earnings management, these initiatives can foster a culture of responsible financial reporting; (7) long-term performance focus - Companies can shift their focus from short-term earnings manipulation to long-term sustainable growth. The research suggests that firms engaging in genuine operational decisions tend to exhibit healthier financial performance over time, contributing to their long-term success; (8) comparative analysis - Companies can benchmark their board composition and real earnings management practices against the study's findings. This can help organizations identify areas for improvement and align their governance structures with industry best practices.

Conclusion and Future Direction

In this study, we investigated the relationship between corporate governance mechanisms, specifically the Board of Directors (BOD) and the Board of Commissioners (BOC), and their impact on real earnings management practices in manufacturing companies listed on the Indonesia Stock Exchange (BEI) from 2016 to 2022. The empirical analysis revealed several noteworthy findings. First, the presence of the Board of Directors (BOD) was found to have a significant positive effect on real earnings management. This result indicates that larger BOD size, increased independence, more frequent board meetings, and greater expertise within the BOD were associated with heightened levels of real earnings management practices. This finding aligns with earlier research by (Al-Thuneibat et al., 2016; Ngo & Nguyen, 2024; Plöckinger et al., 2016), suggesting that the BOD plays a pivotal role in shaping financial reporting practices. However, the influence of the Board of Commissioners (BOC) on real earnings management was not found to be significant. Contrary to expectations, the BOC's presence exhibited a negative relationship with real earnings management, although this relationship was small and statistically insignificant. This result differs from the research conducted by (Alves, 2011; Kolsi & Grassa, 2017; Mohammad & Wasiuzzaman, 2020; Sahyoun & Magnan, 2020; Sun et al., 2014), indicating the need for further exploration of the moderating role of the BOC. Moreover, the moderation analysis demonstrated that the presence of the Board of Commissioners (BOC) strengthened the significant positive relationship between the Board of Directors (BOD) and real earnings management. This counterintuitive result suggests a more intricate dynamic between these governance bodies in influencing financial reporting practices.

Based on the research's findings, several recommendations can be offered. First is to enhance BOD composition and expertise. Companies should strive to maintain an optimal balance of BOD members, ensuring a mix of independent directors, industry experts, and professionals with financial acumen. This can enhance the effectiveness of oversight and decision-making processes. Secondly is to strengthen BOC collaboration. Firms should foster collaboration between the BOC and the BOD to harness their collective influence in promoting transparent financial reporting. Regular interactions and joint discussions can help with more strong governance practices. Then further research is encouraged to dig into the nuanced interactions between the BOC and the BOD in different contexts and industries. Investigating other potential moderating variables may shed light on the complex relationship observed in this study.

This research is not without limitations. The research is confined to the manufacturing sector within the Indonesian context, potentially limiting the generalizability of the findings to other industries or countries. Additionally, the study focused solely on the moderating role of the BOC without exploring other potential moderating factors. Future research could extend the analysis to include a broader range of governance mechanisms and explore the dynamics in different economic and regulatory environments. In conclusion, this research contributes to the literature on corporate governance and real earnings management by examining the roles of the Board of Directors (BOD) and the Board of Commissioners (BOC) in influencing financial reporting practices. The results shed light on the complex interactions between these governance bodies and offer insights into their potential collaborative effects. As corporate governance continues to evolve, understanding these dynamics is crucial for fostering transparent and ethical financial reporting practices.

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