BREAKING BARRIERS: FEMALE DIRECTORS, EARNINGS MANAGEMENT, AND THE INFLUENCE OF EDUCATION AND SUSTAINABILITY REPORTING

Mariska Ramdana[1], Vincent Tio Pratama[2], Dea Tiara Monalisa Butar-Butar[3]

Affiliation :

[1,2,3]Accounting Study Program, Faculty of Economics and Business, Batam International University.

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***corresponding:**
mariska@uib.ac.id

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Abstract

Background: The role of women directors in corporate governance has received increasing attention, especially regarding their impact on earnings management. Recognizing this role is critical as companies need to increase transparency and accountability in their financial practices, while recognizing the role of sustainability.
Objective: These studies aim to find out, whether female participation in the board of directors can reduce earnings management practices, by adopting different types of measurements for the female variable.
Research Method: The applied methods are purposive sampling where 49 samples collected from Indonesia Stock Exchange (IDX) that consistently publishing financial and sustainability report with a timeframe of 2018-2022. Implementing data panel regression method using Stata application.
Result: The result indicate that, three female director can reduce earnings management, while independent commissioner and GRI disclosure are positively related to earnings management.
Originality/Novelty of Research: This studies use different kind of measurements towards female director variables, to proving applied theory are still relevant and to resolve the limitation of previous studies to find the critical effect of female directors participation to decreasing earnings management in Indonesia.
Keywords: Female Director, Female Education, CSR Disclosure, Independent Commissioner, Earnings Management.

Introduction

Earning management can be defined as the exercise of management discretion within GAAP regarding external financial reporting by exploiting gaps in contracts, limitations of stakeholders' rationality, and information asymmetry in the market. This can be achieved through economic decision-making, alterations to accounting treatment, or other complex methods (Malek, 2018). It is important to note that this definition excludes any discretionary or discretionary actions taken by management. The issue of earnings management and the quality of earnings reported by companies is crucial since these earnings estimates signal the financial circumstances of companies to interested parties such as investors. With earnings management, the financial performance showed in the financial report are no longer relevant (Lev, 2018). Financial data is crucial in describing a company's performance in a given period, as one of main goals for investing are profit, Company directors have a professional and ethical responsibility to ensure that those utilizing financial reports, where financial information is a critical factor in making investment decisions.

Years after the discovery of accounting scandals and frauds, such as General Electric in America in 2019 and PT Garuda Indonesia in 2019, scholars have focused on their true motives for engaging in earnings management practice. Strakova (2021) discovered a variety of reasons to engage in earnings management. Since financial information can be misleading, all stakeholders, investors, and users of financial information require tools that can restricts managers' proclivity to engage in financial fraud.

Previous research has linked directorships as a monitoring tool to curb earnings management; thus, this paper focuses on the impact of on earnings management in organizations. Women are considered as a useful tool for monitoring and seizing opportunities, but they are also at risk of engaging in malpractice activities due to their decision-making skills. Women are more carefull and less violent than men in a variety of decision-making scenarios, less concerned with economic results, and less tolerant of opportunistic behavior. Moreover, females are less likely to engage in fraudulent practices (Cristiano & Yopie, 2021; Ho et al., 2015).

Female board participation is a significant focus for board diversity. Currently, there are no rules regarding female board participation in Indonesia. However, Malaysia and European Union countries aim for diverse gender composition on boards with a female percentage of 30% (Malaysian code of corporate governance, 28 April 2021) and 40% (Official EU journal, 7 December 2022), respectively.

Several researchers have studied the impact of women on a company's earnings management. These studies include works by (Arioglu, 2020; Miladi dan Chouaibi, 2021; Karina, 2021; Zalata et al., 2022; Saona et al., 2019; Hala; 2019; Gull et al., 2017; Zhao et al., 2020; and Anh & Khuong, 2022). Their results show that women are effective in constraining opportunistic practices in earnings management. Previous research has focused on the proportion of women directors in examining the relationship between female participation on boards and earnings management (Karina et al., 2024). Our study expands on this research by investigating the impact of women on boards of directors. Based on previous studies, we have decided to employ Critical Mass Theory (CMT) as inspired by Torchia et al (2011) instead of solely relying on female percentages. Our aim is to investigate the potential critical mass of females, who are considered as tokens due to their minority status on boards. Our investigation seeks to determine whether one, two, or even three women on a board can be considered critical mass.

Next, to address previous research recommendations by fellow researchers Dwijayanti et al. (2020) and Zalata et al. (2022), we examine the effect of female educational background as an independent and moderating variable. Accounting education plays a crucial role in financial planning , and Mariana and Maria (2016) argue that in the topic of accounting and finance, the value of accounting frameworks provides guidance to ensure quality and report financial statements as 'true and fair', thus reducing earnings management. There is little research that examines women's education in relation to earnings management. Jiacai (2016) discovered that knowledgeable women are less likely to involve in earnings management activities.

Furthermore, we also adding GRI disclosure as independent and moderating variables since earnings management are known as a ethical issues, (Almahrog et al., 2018) argued that firms that reporting their sustainable report are negatively associated with earnings management activities.

Lastly, we adding corporate governance and firm characteristic namely, Board Size (BOSI), firm Size (FISI), firm Age (FIAG) , Firm Leverage (FILE), and Total Liabilities (TOLI) as control variables. Previous studies by Githaiga et al, (2022) found that BOSI and FIAG are negatively influence earnings management while FIAG are positively related to earnings management, as explanation BOSI and FISI the smaller the size, the monitoring become simple due to smaller area of monitoring. Nguyen et al., (2023) The findings revealed a positive association between leverage and liabilities for earnings management activities. Among five control variables we found only FISI and FILE have significant result where FISI are negatively related and FILE are positively related towards earnings management, Firms with higher liabilities are more likely to engage in earnings management activities and comply with convenant requirements (DeFond & Jiambalvo, 1994).

Our study contributes to the literature by implementing Critical Mass Theory (CMT) as a addition to female directors measurement. Previous studies have produced inconsistent results when using only the percentage of female directors as a measurement, especially when the proportion of female directors is lower than male directors. As a result, we break the barrier that prevents women from contributing to board decisions. As a result of this research, CMT are enable minority group to have an impact in the board.

The paper is structured as follows. The first section is the introduction towards this research, which is placed on the first page of the paper. The second section includes a literature review and hypothesis development. The third section describes the research methodology and provides an interpretation of the collected data. The fourth and final section presents the study findings, followed by a conclusion.

Literature Review

Critical Mass Theory

Critical mass theory (CMT) indicate that When a sub-group reaches a certain critical mass in terms of size, it gains the ability to influence the group's overall decisions (Torchia et al., 2011). Kanter (1977) According to research, women on boards consist of the following: uniform groups (0% women), skewed groups (up to 20% women), skewed groups (20-40% women), and balanced groups (40-60% women). In general, the presence of at least three women on the board represents the "critical mass" of female directors (Torchia et al., 2011). In more specific terms, (Liu et al., 2014) have suggested that, under CMT, having one (token), two (presence) and three (voice) is sufficient. This suggests that, According to the CMT perspective, having women on boards can lead to better performance, particularly in terms of innovation. However, this is only true when there are enough women on the board that they can have a real impact on board decisions (Torchia et al., 2011).Results of having one (token), two (presence) and three (voice) is that a firm will have better performance than if there were fewer women on the board (Liu et al., 2014). Furthermore, firms with three or more women on their boards tend to have more CSR disclosures (Jia & Zhang, 2013). Notably, CMT has rarely been used in previous studies to design and explain the factors influencing female directors and their impact on earnings management.

Legitimacy Theory

Legitimacy theory (LT) assumes that company action towards managing and maintaining key stakeholder perspectives occurs through company transparency of the situation. Suchman (1995) describes legitimacy as a widely accepted assumption that a company's actions are appropriate within a socially constructed value system, beliefs, and, most importantly, norms. According to LT, a company gains legitimacy if its actions correspond with the system of values of the society in which it operates (Ntim, 2016).The same point is made by (Deegan et al., 2002) that organizations are continuously going to make sure to that their sure to support to sociocultural boundaries and norms. Social legitimacy is essential because society, as the primary consumer, is one of the primary reasons for a business to exist.

Female Director and Earnings Management

Several studies have found that having female directors can improve the quality of accounting information (less earning management) by promoting transparent and responsible corporate governance (Adams & Ferreira, 2007; Hillman et al., 2007). This may be achieved because women have a higher curiosity than men, making it easier for women to obtain information about their colleagues. At the same time, women are more willing to disclose specific information (Srinidhiet al., 2011) and are less concerned with financial results (Khrisnan & Parsons, 2008).

Since female directors are also part of the board as a monitoring tool, Several researchers have examined into the impact of female directors on earnings management. Krishnan and Parsons (2008) discovered that female directors in senior management have a positive relationship with the quality of reported earnings in a sample of US firms, supporting the argument that ethically conscious female directors reduce the firm's tendency to engage in aggressive accounting practices such as earnings management, (Belal et al., 2021) research with Jordanian firms as their sample found that female director have negative effects towards earnings management, as a result female directors on boards are more effective in performing the monitoring role. On the other hand, (Arioglu 2020) finds no significant relationship between female directors and earnings management based on a sample from Turkey. The result is likely due to cultural differences and gaps in gender equality.

Instead of only using percentages, we are implementing Critical Mass Theory to analyze the effect of female directors on earnings management. This is because previous studies have shown contradictory results when measuring percentages, so we propose our first hypothesis:

H1: Female directors have a negative and significant correlation with earnings management.

Female Education on Earning Management

To a certain extent, an individual's education can serve as an indication of their knowledge and skills. Thus, it can influence decision-making proficiency, along with skills and knowledge development in the field. Emphasis in business education, MBA courses are designed to attract and develop risk-averse students while also teaching them analytical skills that aim to prevent huge mistakes or losses (Gottschalk, 2006). With a qualified education level and directors possessing high education, decision-making can become more extensive and systematic, resulting in wise decisions (Hambrick & Mason, 1984) and manages earnings management more effectively (Chi & Gooda, 2023)

Various forms of professional education are necessary for effective company management and decision-making. However, there has been limited research on the impact of education background of female directors on earnings management. Jiacai (2016) found a significant negative correlation between the female directors education and earnings management in a sample of Chinese companies, so we propose the second hypothesis:

H2: Female directors with an accounting education background have a negative and significant effect on earnings management.

H2a: Education in female directors as moderation strengthens the negative effect on earnings management.

CSR Disclosure and Earning Management

From a legitimacy theory perspective, the brand of the company in the public are one important factor for company continuity. This theory argues that ethical, commitment and management reputation factors in disclosing sustainability reports fulfill the “social contract” as a result companies are encouraged to reporting high quality financial reports (Muttakin et al. 2015).

Regarding the practice and practice of reporting sustainability reports in Indonesia with the existence of the Financial Services Authority Regulation Number 51/POJK.03/2017 of 2017 stated, Financial Services Institutions, Issuers and Public Companies are required to report sustainability reports. However only 135 issuers reported sustainability reporting out of a total of 776 with a percentage of 17.3% which is classified as low rating.

Previous research has provided two perspectives on the relationship between earnings management and disclosure of sustainability reporting. The first point of view states that companies that make sustainable reporting disclosures tend to minimize the existence of earnings management practices as previous research by (Kumala, Siregar 2019) with a sample of mining companies in Indonesia shows that there is a significant negative relationship between disclosure of sustainability reports and earnings management. In South Korea, (Choi et al. 2019) Companies that reported sustainability reporting were less likely to be involved in earnings management than those that did not participate in sustainability reporting pratice. (Yousf et al. 2018) found a significant negative relationship between sustainability reporting and the additional statement that companies with higher sustainability reporting scores reported lower earnings management than companies with lower sustainability reporting scores. The second point of view (Abner & Ferrer, 2019) with objects in the Philippines which found a positive relationship from GRI reporting with practices earnings management with GRI reporting findings is used to cover up or as a shield from earnings management practices.

H3: Disclosure of sustainability reports have negative and significant effect on earnings management.

H3a: Disclosure of sustainability reports as a moderation enhanced the negative relationship between female and female education towards earnings management.

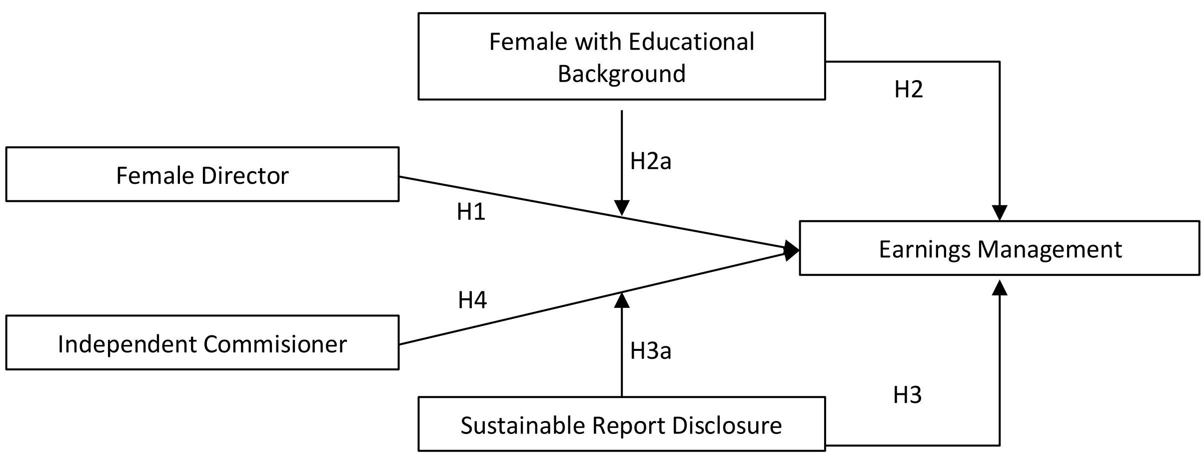
Independent Commissioner and Earnings Management

According to agency theory, managers can increase their profitability because of information asymmetry between management and shareholders. This can result in losses for the company due to irregularities in management performance. Therefore, good corporate governance is generally practiced by the company. However, implementing good corporate governance raises a new problem: the company must pay more for agents to supervise its performance (Ramadhan & Firmansyah, 2022). This creates agency costs, which signify agency problems that can decrease value of the company (Pratiwi & Yulianto, 2016). According to Putri and Rachmawati (2018), the board of commissioners plays a crucial and effective role in the corporate governance of a companyAn independent board can provide the company with an independent board of directors. The board's commissioners have more control over affect the probability managers, which can of their misconduct. The board of commissioners can identify potential financial issues associated with poor management performance and provide an assessment of the company's performance. Research conducted by Rahmawati (2012) and Fathonah (2017) support these statements. The role of the independent board of commissioners is to monitor potential deviations in managers' performance within the company independently and without external influence (Yuliani & Rahmatiasari, 2021). The existence of independent commissioners can lower the practice of earnings management and evaluate the company's performance, preventing financial misdirectionTherefore, the fourth hypothesis of this study is:

H4: Independent commissioners have a negative and significant effect on earnings management

From the hypothesis above, we can capture the research model as follow:

Image 1. Research Model



Research Method

The sample selected in this study consisted of over 800 companies listed on the Indonesia Stock Exchange with the criteria of reporting annual reports and consistent GRI reporting from the 2018-2022 timeframe. With purposive sampling from the criteria above, the authors get a total of 49 companies as secondary database in this studies. From quantitative data panel extending in a 5 years period, first phase for the regression are removing the outlier’s data then observing the relationship between variables using Fixed Effect Model (FEM) regression using Stata application.

Table 1. Variable Measurement

Panel A: Earnings Management (Dependent Variable)		
Earnings Management	EAM	$TA_{it} = \beta_0 + \beta_1 \frac{1}{ASSETit} + \beta_2 (\Delta SALES_{it} - \Delta AR_{it}) + \beta 3PPE_{it} + \beta 4ROA_{it}-1 + \in_{it}$
Panel B: Female director measurement (Independent Variable)		
Female Director 1 (1 Female)	FD1	1 if there are 1 female director and 0 if none
Female Director 2 (2 Female)	FD2	1 if there are 2 female director and 0 if none or less
Female Director 3(3 Female)	FD3	1 if there are 3 female director and 0 if none or less
Female Director (Percentage)	FDPR	Percentage of female director compared to board size
Panel C: Independent Variable		
Female with accounting education	FAED	Number of female with accounting education
Independent commissioner	INCO	Percentage of independent commissioner ratio on board
Sustainable report disclosure	GRID	$\frac{\Sigma \text{ Items Disclosed}}{89\ Items\ GRI}$
Panel D: Control Variable		
Board size	BOSI	Total number of director
Firm size	FISI	Log natural of total Asset
Firm age	FIAG	Firm operational period since established
Total Liabilities	TOLI	Total liabilities of the company
Firm Leverage	FILE	$\frac{Total\ Liabilities}{Total\ Asset}$

Results and Discussion

Table 2 shows a descriptive statistical analysis of the data collected for 49 sample companies listed on the Indonesia Stock Exchange (IDX) with a timeframe of 2018-2022. The Earnings Management (EAM) variable shows an average yield of 0.34056, meaning that the companies selected as samples practice earnings management of their assets with an average value of 34 %. FDPR shows an average of 10.9% female directors from 245 data. INCO shows that from the sample collected an average 40% of independent commissioners on boards. FAED shows that of all female directors, 1.7% of them have an accounting education background. GRID shows an average of 38% which means that from a total of 245 data, companies only report 38% of the 89 items in the GRI.

Table 2. Descriptive statistics

Variables	Min	Mean	Max	Std.Dev
EAM	-0.4725	0.34056	1.19158	0.45736
FD1	0	0.29796	1	0.25459
FD2	0	0.06967	1	0.14168
FD3	0	0.02049	1	0.15065
FDPR	0.0%	10.9%	66.7%	0.13029
INCO	16.7%	40.2%	83.3%	0.07209
FAED	0.0%	1.7%	66.7%	0.20140
GRID	0.045	0.388	0.978	0.20140
BOSI	3	6	15	2.12180
FISI	901,060,986,000	39,363,886,435,283	413,297,000,000,000	56,917,016,318,468
FIAG	5	45.4	116	23.8
FILE	0.04803	0.53163	1.8519	0.24844
TOLI	121,957,837,400	22,401,525,746,158	190,394,739,780,266	32,801,143,532,193

Source: Processed by the author (2023)

In order to choose between FEM, REM, and CEM as the optimal models to use in this investigation, we ran 2 tests presented in the table below.

Table 3. Chow Test Result

Effect Test	Propability
Prob > Chi2	0.0041

Table 4. Hausman Test Result

Effect Test	Propability
Cross Section Random	0.0011

From the table above both test show the result of <0.05 therefore FEM is the optimal model used in this research.

Table 5. Hypothesis test

VARIABLES	EAM		x FAED		x GRID	
	COEF	Prob	COEF	Prob	COEF	Prob
FD1	-0.005	0.627	-0.281	0.238	0.005	0.849
FD2	-0.000	0.991	-0.335	0.179	-0.012	0.715
FD3	-0.199	0.000	x	x	0.453	0.000
FDPR	-0.023	0.457	0.145	0.160	1.059	0.000
INCO	0.404	0.000	0.639	0.011	x	x
FAED	0.043	0.059	-	-	x	x
GRID	0.391	0.000	0.793	0.000	-	-
BOSI	0.000	0.786				
FISI	-0.005	0.042				
FIAG	-0.000	0.182				
FILE	-0.007	0.296				
TOLI	2.733	0.003				

Notes: x = Regression aborted due to multicollinearity

From the table above shows that FD have negative effect on EAM, in this regression only FD3 has a significant effect on earnings management therefore H1 is Accepted. This result contradicts (Sofian et al., 2020) findings where there no effect of female presence on board on earnings management. As result of applying CMT where 3 female have critical impact even as the minority group of gender on boards. This study supporting (Torchia et al., 2011, Rossi 2017) Findings that at least three women directors make boards more diverse and allows majority-minority interactions and processes to take place, thereby enabling the overall board to make high-quality decisions, as a result of the greater number of female on board have positive impact on company value, On the other hand, having a small number of female board members does not allow them to participate and influence decision-making discussions, this result also in line with Dobija et al., (2022) findings where female participation is critical mass of female is achived the voice of the minority grup are accepted as a voice and brings value in board decision making.

H2 are rejected, in this case FAED have insignificant relation with earnings management, as a result of low number of female director with accounting education background with the average number of 1.7% resulting in insignificant relationship towards earnings management, because of the minimum sample of FAED in this research we failed to find the relationship towards earnings management directly. This result contradict Jiacai (2016) and bilal et al. (2023) with 34% and 22% directors with relevant education respectively, resulting in the ability to constrain earnings management and more behavioral decision making.

INCO has a positive and significant relationship with earnings management therefore H3 is rejected. This suggests that the appointment of an independent commissioner is still unable to curb earnings management practices, this is the result of lack of independency in monitoring the board and lack of educational background therefore they didn't have the prespective of earnings management and how to avoid it. This finding is in line with Sari et al (2021) findings where the appointment of independent commissioner is only for the purpose of compliance and formality with the laws and regulations applied in Indonesia, additionally weak performance and lack of independence resulting in ineffective supervision as a result unable to restrain earnings management (Nugroho & Firmansyah, 2018).

GRID shows positive significant results with coef 0.391 and P value 0.000 therefore H4 is rejected. This result suggesting that the more of GRID disclosure the more earnings management practice occurs, by improving the GRID there are also more gaps of company legitimacy to practices earnings management. This results are in line with Rina (2019) and (Mahrani & Soewarno,2018) findings, suggesting that when the board performs earnings management practices, it could be beneficial to the society if GRID is used to shield the earnings management practices as it means more social activities extended to larger stakeholders. This result in line with legitimacy theory perspective where the key aspect of disclosing information is to build legitimacy from companies transparency, in this case the information disclosed by the company are blurred representation in the goals to make the society think that the company are comply to the social constructed values, belief and norms.

FAED as a moderation are insignificant to all the female directors' and independent commissioner variables towards earnings management, therefore H2a is rejected. This occurs due to the small number of FAED participation from the table 2 above showed the percentage are 1.7%

from the total of 10.9% of female directors included in this. Lastly FAED as a moderation towards GRID as hypothesis 3a are rejected, due to the small amount of FAED participation in the sample we were unable to curb the positive result of GRID towards earnings management, and GRID as moderation are insignificant to FD1 and FD2 due to ingsinificant result in regression by solely rely on FD1 and FD2 towards earnings management, and positively significant towards FD3 and FDPR suggesting that in this research the positive effect of GRID towards earning management can reversing the negative effect instead of enhancing the negative effect of the sole regression result of FD3 and FDPR, therefore H3a are rejected.

Conclusion

Results from this research suggest that female critical mass matter in constraining earnings management practice, with evidence from the regression result that only three female directors showed a negative and significant relationship from four different measurements on female director variables. GRID is unable to curb earnings management, it can be concluded that in this case GRID are tools and disclosed as a formality purpose and fulfillment of government policy in effort to look legitimate from society perspective. INCO has positive impact towards earnings management, contradicting the expected outcome with evidence of significant and positive results.

This studies proving female participation on board should be considered by both patricians and regulators since Indonesia currently didn’t have any regulations about the minimum participation on boards, meanwhile other countries like Malaysia and European countries have regulations specifically about female’s participation on boards even through it have not fully complied but companies already moving to reach the targeted amount of females on board.

This studies also implicate for researchers by proving that CMT is still relevant, with regression above showed that critical mass number of female (3 females) have achieved significant effect in this regression compared to lower number of female and percentage as the measurement.

This research is far from perfect in explaining the relationship between each variable therefore there are still limitations such as, there are small amount of research regarding female directors with relevant education either directly or indirectly towards earnings management. In this research samples were filtered with criteria that enabled the focus on examining all of the variables included directly towards earnings management. Moreover the time span of this research are only 5 years 2018 until 2022 and from the filter applied only 49 samples meet the criteria, as a result unable to investigate deeper the direct relationship between independent variable used in this research. As addition in Indonesia have a lower female director on board participation compared to neighboring countries Malaysia and Europe based country where regulators already determine the minimum number of female participation.

Therefore future studies need to investigate further the impact of variables directly towards earnings management without too many filters, as an example, female directors, female directors with relevant educational background, and comparison between female with relevant background and without relevant educational background directly, in an attempt to fully understand the impact of female itself towards dependent variables. Also by adding relevant variables such as sustainable factor and financial conditions.

As a reference for the future research with the similar model, instead of using quantitative method, researcher may using qualitative method. Or perhaps conducting a research using premier data with specified area of samples such as the locals company to find specified factors like culture, distinctive attributes of the region and social attributes.

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