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Female Board of Directors and Earnings Management: The Mediating Role of Profitability

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ABSTRACT

This study aims to determine the influence of a female board of directors on earnings management. The mediating role of profitability was also studied to determine the influence of profitability in improving the relationship between the female board of directors and earnings management. The study was conducted on public companies listed in Indonesia Stock Exchange with a sample of 408 companies with annual report data from 810 Indonesian companies for 2018-2021 listed on IDX. The study used panel data regression with FEM (Fixed Effect Model) as the model to analyze the data using Eviews 12 application. The findings of this research indicate that female boards of directors do not influence earnings management. However, company profitability has a significant negative influence on the influence of a female board of directors on earnings management. Companies with more women on their board of directors tend to reduce earnings management practices when the company has good performance. This research provides practical implications for managers to consider gender equality in management. Studies regarding the role of profitability in moderating governance structure and earnings management are still rarely discussed. This research provides a theoretical contribution to the literature where a company's governance structure can influence earnings management practices depending on company performance.

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1. INTRODUCTION

Earnings management is a practice within a company that has the potential to weaken investor confidence. Obtaining accurate company information might become challenging as a result. This is because managers may intentionally provide imbalanced information to manipulate the company's financial reports, portraying a more favorable image to the public (Anh and Khuong, 2022). In recent years, several public companies in Indonesia have been involved in earnings management cases. These cases involve instances where companies violated the principle of presenting reports by predetermined standards, resulting in the presentation of higher profit figures than the actual values (Ghaleb *et al.,* 2021). Agency theory implies the existence of asymmetry in providing information that is different from what happens to the company. Companies that carry out earnings management actions in Indonesia, one of which is PT Envy Technologies Indonesia Tbk (ENVY) in 2021, which accuses its subsidiary, namely PT Ritel Global Solusi, of manipulating the 2019 consolidated report. This case is supported by the fact that there were several unusual increases in revenue and net profit from the previous year, namely the company's revenue in 2019 was IDR 188.58 billion, while revenue in 2018 was only IDR 80.35. Meanwhile, net profit has also increased from before, which in 2018 was only IDR 6.79 billion, and in 2019 it became IDR 8.05 billion (Christian *et al.,* 2022). Based on evidence from earnings management case data at PT Envy Technologies Indonesia tbk., it is necessary to investigate more deeply why the company can report false financial statements and accuse its subsidiaries. Earnings management has been studied over decades in accounting studies, however, the role of the female board of directors in the management and how they react to the practice of earnings management is still being investigated these days. According to Lückerath-Rovers (2013), companies with female directors perform better than those without female directors.

The presence of women on boards is one of the intriguing topics discussed in recent years. This is due to the prevailing belief in Indonesia that men are better suited to hold senior positions within companies (Trisanti, 2021). According to research by Carter et al. (2010) in developing countries, it is suggested that companies can contemplate having women on their board of directors to fulfill their responsibilities. This is also related to stakeholder theory, where the board of directors of a company must report the company's finances and must also provide benefits to internal parties, namely stakeholders, and external parties to the company, namely the community and government (Heryana *et al.,* 2022). This is because a greater representation of women on the board enhances decision-making within a company and can oversee corporate governance to mitigate the impact of earnings management actions, as we know that good corporate governance practice might affect earning management in an organization (Yopie, 2021; Karina, 2021). Organizational theory in accounting science in the field of management, organizing, and leadership claims that female boards have better organizational performance because of the different views, skills, and attitudes that women bring (Zalata and Abdelfattah, 2021). This is because the duties of a board member are to supervise and monitor the company, one of the suitable monitoring positions for a female director is the audit committee (Zalata and Abdelfattah, 2021).

Profitability as measured by Return on Assets is a supporting factor related to the female board of director's effect on earnings management. To increase a company's profits, management often carries out activities that violate the rules such as earnings management actions to produce a good corporate image. Christiana (2020) suggested that earnings management can be influenced by the proportion of female board of directors and profitability. Female board of directors on the board tend to be associated with a reduced likelihood of earnings management actions within the company (Xiaomei *et al.,* 2021). Xiaomei et al (2021)

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revealed that having women on the board positively affects company performance, aligning with the hypothesis that a female board of director presence significantly counters profit-oriented management practices. This alignment is attributed to the fact that female board members generally exhibit a stronger focus on and concern for the company's interests over personal ones. The study conducted by Ghaleb et al (2021) also presented the results of the study that female board of directors had a negative and significant effect on earnings management because women are more sensitive to ethics. Research conducted by Khan et al (2021), explains that female board of directors contribute to robust and stable company leadership in the context of investment decisions. Having women on the board can significantly diminish the likelihood of earnings management actions, as women board members tend to exhibit better financial performance for the company. This includes higher-quality earnings and greater Return on Assets compared to their male counterparts, where the greater the company's profitability, the higher the investor's confidence in investing has an impact on increasing the value of the company (Sulistyawati and Ratmono, 2023).

Many researchers have explored the impact of female board of directors on earnings management through various studies, including those by Trisanti (2021), Carter et al (2010), and Arioglu, (2020). However, some of these studies have not investigated the influence of female board of directors' decision-making on the extent of earnings management concerning other factors, specifically profitability. The influence of profitability might bolster the effect of female board of directors on earnings management because women on the board tend to exercise better control over company performance, leading to higher Return on Assets and increased company profits. As a result, there is a reduced need for resorting to earnings management actions. This study aims to determine whether a significant correlation exists between women serving on the board of directors and earnings management to investigate the relevance of female boards of directors to effective company leadership and their tendency to eschew earnings management practices. Another objective is to assess the level of significance of profitability in earnings management when women hold positions as company directors. A study by Maurung et al. (2019) shows the relationship between female board of directors and profitability. However, the study did not use ROA as the measurement of profitability. Another study that uses ROA is Purnama and Nurdiniah (2019) who studied the relationship between Profitability and Profit Management. The profitability in this study is an independent variable and only relates to the dependent variable of earnings management, so there is no connection to the female board of directors. From the literature reviews, there has been no study that uses ROA as a measurement of profitability to moderate the relationship between female board of directors and earnings management. Thus, this study fills the gap in the literature to bring new knowledge regarding the significance of profitability in affecting the relationship between the female board of directors and earning management practice.

2. METHODS

In this study, the method used is the quantitative research method. Quantitative research is a research method used to examine certain populations and samples, in which data collection is obtained through research instruments, and data is analyzed with statistical characteristics, aiming to test established hypotheses (Henson *et al.,* 2020).

The object of this study is the female board of directors who serve in public companies (Tbk). This study aims to ascertain whether there is a connection between the female board of directors and earnings management, as well as whether the female board of directors is linked to performance and impact on earnings management. In terms of operational variables, this study encompasses five factors: the size of the female board of directors, earnings management, return on assets, leverage, and firm size. Leverage and firm size are the control variables used in this study.

Table 1. Variable formulas

Source	Variable Type	Variable Name	Formula
Maurung, Tjitrohartoko, and Christiawan (2019).	Independent	Female Board size	Calculation ratio of (Non-independent female directors + independent female directors) / total board directors in the company
Fatimah, (2019).	dependent	Earnings Management (AEM) Jones model	Total Accruals (TAC) = NIit – CFOit *Ordinary Least Square* (OLS) $\frac{TAC_t}{TAi_{t-1}} = a_1\left(\frac{1}{TAi_{t-1}}\right) + a_2\left(\frac{\Delta REV_t}{TAi_{t-1}}\right) + a_3\left(\frac{PPE_t}{TAi_{t-1}}\right)$ eit Regression Nondiscretionary accruals (NDAs) $NDA = a_1\left(\frac{1}{TA_{t-1}}\right) + a_2\left(\Delta REV_t - \frac{\Delta REC_t}{TA_{t-1}}\right) + a_3\left(\frac{PPE_t}{TA_{t-1}}\right)$ *Discretionary Accruals* (DA) $DA_{it} = \frac{TA_{it}}{A_{it-1}} - NDA_{it}$
Sugiyono, (2019).	Moderation	*Return on Assets*	Calculation ratio of net profit after tax / total assets
Sugiyono, (2019).	*control*	*leverage*	Total Liabilities / total assets
		firm size	Linear of total assets

The sampling technique uses purposive sampling, meaning that the sample is selected based on certain criteria by the research objectives and data collection techniques used in this research is the document study method, according to Arifien (2016) research using the document study method, the data obtained is more accurate and can be trusted as evidence in research testing. This approach includes collecting and processing quantitative data from related documents, where the data comes from the annual reports of several public companies listed on the Indonesia Stock Exchange (BEI). In 2021, the total number of public companies listed on the Indonesia Stock Exchange will be 810 issuers. For this research, data was collected from 408 companies that have been filtered and have complete financial reports and have been officially published on the IDX website, with information covering the years 2018 to 2021 with the currency used as rupiah.

Research conducted by Fatimah, (2019) on earnings management variables also used the Jones formula for the discretionary accruals model in 1991 by first collecting financial report document data, namely consisting of TAit (Total company accruals in that year), Ait-1 (Total

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assets in the year before the research), ΔREVit (Difference between income from the research year and the previous year), PPEit (plant, property and equipment), NDAit (Nondiscretionary accruals of the company in that year), NIit (the company's net profit in that year), CFOit (the company's operational cash flow in that year), ΔREC (Difference between the research year's accounting and the previous year), DAit (the company's discretionary accruals in that year), PPEit (Total tangible assets of the company in that year).

Data analysis methods used in this research include descriptive statistics, panel regression, Chow test, Hausman test, Lagrange multiplier test, F test, t-test, and coefficient of determination test. This analysis was carried out using the EViews 12 application. Descriptive statistics consist of mean, median, minimum, and maximum values to describe sample data objects directly in outline without analyzing and making conclusions (Firmansyah *et al.,* 2022). To find out the test results from the data that has been collected, a panel regression test is carried out to select the best model to use at the test stage for reading the results. There are three-panel regression models, namely Pooled Least Square (PLS) which is processed using time series and cross-section data, the Fixed Effect Model (FEM) is a model that can show comparisons between objects, and Random Effect Model (REM) is a model that uses residuals that can be linked to objects and over time. The selection of the best model can be adjusted to the circumstances of the existing data sample. To produce the right model, the Chow test, Hausman test, and Lagrange multiplier test are needed (Tripena, 2022).

The Chow test is a test to determine the most appropriate model using the PLS or FEM method in estimating panel data. There are two possibilities, namely if the prob number is greater than 0.05 then the test uses the PLS model in the research, and vice versa if the prob number is smaller than 0.05 then REM is used. This is different from the Hausman test which aims to determine the next model to be used, namely the REM or FEM method. The results of the Hausman test follow the test results of the chi-square statistic, the provisions are that if the prob number is above 0.05 then use the REM model method, whereas if the prob is below 0.05 then use the FEM model method. The Lagrange Multiplier test aims to compare the common effects method with the random effects (REM) method. When the results of data testing show a small result of a probability of 0.05 then the suitable method to use is REM, whereas if the probability is above 0.05 then it is more suitable to use the common effect (Henson *et al.,* 2020).

The F test is used to determine whether the relationship between the independent and dependent variables has a significant influence, the dependent and independent variables do not have a significant influence if the prob is greater than 0.05. Meanwhile, the dependent and independent variables have a significant effect if the probability is smaller than 0.05. Testing The t-test is also used to determine the influence of the independent variable on each variable in the research model. When the significant number is smaller than 0.05, the independent variable has a significant influence on the dependent variable. If the significant number is greater than 0.05 then the independent variable does not have a significant influence on the dependent variable. The coefficient of determination test or R-square test is a test of the ability of the independent variable to influence the dependent variable, which is used to show the suitability of the numbers to the regression model being studied. The higher the number in the R-square test results, the more suitable the regression model used (Arifien, 2016).

3. RESULTS AND DISCUSSION

The following **Table 2** is the descriptive analysis of the variables examined in this study.

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Table 2. Descriptive statistics

Variable	N	Minimum	Maximum	Average	std. Deviation
Female Board of Directors	1904	0.00000	1.00000	0.15095	0.18935
Earning Management	1904	-1.76094	2.25927	0.00456	0.24949
Return On Assets	1904	-6.04697	2.93279	0.00577	0.28897
Company Size (in trillion)	1904	8.278,41	1.725.611.128	29.618.821,98	125.426.004,07
Leverage	1904	0.00010	700.41745	1.19606	1.65501

Source: Processed secondary data (2023)

Based on the results of the statistic descriptive analysis above, it can be concluded that the data from 2018 to 2021 about the independent variable, namely the size of the women's board of directors, explains that in IDX companies, the average size of women serving on the board of directors is 0.15095 smaller than 0.5. This indicates that the representation of women on the board of directors at Indonesian IDX Companies is relatively small.

The average earnings management value is 0.00456. This suggests that earnings management measures are very low, amounting to only 0.4%. As a result, it can be inferred that companies listed on the IDX do not heavily engage in earnings management practices. This observation is further supported by the substantial difference between the maximum value of 2.25927 and the minimum value of -1.76094. Despite this disparity, the standard deviation remains relatively low at 0.24949, implying that earnings management across IDX companies does not exhibit significant variability. Meanwhile, the Return on Assets (ROA) average value is 0.00577. This indicates that the ROA variable exhibits a relationship with the presence of female board members at IDX companies in Indonesia. It suggests that companies may be less effective in optimizing profits using their available assets, as the obtained average ROA is notably low.

3.1. Hypothesis Test of Female Board of Directors and Earnings Management

The most suitable model for this hypothesis is the proportion of female board of directors, which has a significant negative impact on earnings management according to the Fixed Effect Model (FEM). This conclusion is supported by the Chow test result, which indicated a probability of 0.0000, and the Hausman test, which showed a probability of 0.0001. Therefore, conducting the Langrage Multiplier (LM) test is no longer necessary, as the optimal model has been identified as the Fixed Effect Model (FEM).

Table 3. Board directors of women and earnings management

Variable	Coefficient	t-statistic	Prob.	Conclusion
Constant	0.153978	0.612828	0.5401	
Female Board of Directors	-0.093463	-1,145,838	0.2521	Not significant
Company Size	-0.004683	-0.539074	0.5899	Not significant
Leverage	0.000013	0.041052	0.9673	Not significant

Source: Processed secondary data (2023)

Based on the outcomes of the t-test, the probability of female directors influencing earnings management is 0.2521, which is above 0.05. This indicates that there is no significant negative impact on earnings management attributed to female directors. The findings suggest that the presence of a female board of directors does not significantly affect earnings management. This lack of significance can be attributed to the relatively low representation of female board of directors within the sampled IDX companies, which consequently does not exert a notable

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influence on earnings management practices (Chen and Gavious, 2016). The results of this study are also in line with the study by Sofian et al (2020), which explains that earnings management actions are not influenced by a female board of directors in Indonesia. The greater the presence of a female board of directors in a company does not impact the company's ability to deter earnings management. This aspect is noteworthy as companies often engage in earnings management actions to evade losses. The findings are also related to the preliminary discussion with the urgency of the study, which is the relevance of female board of directors to effective company leadership and their tendency to avoid earnings management practices. To resolve these problems, women can become company boards however there is no significant effect on earning management practices. This is in line with research conducted by Xiaomei *et al.,* (2021) which revealed that the presence of women on the board of directors has a positive impact on company performance. This partiality is because female board members are generally more focused and pay attention to the interests of the company rather than personal interests, thus they will not affect the practice of earnings management.

3.2. Test hypothesis Female Board of Directors on Earnings Management Moderating by ROA

The most appropriate model for this hypothesis is the Fixed Effect Model (FEM). Both the Chow test and the Hausman test yield probabilities of 0.0000, which are below the significance threshold of 0.05. Therefore, conducting the Langrage Multiplier (LM) test is unnecessary, as the optimal model, the Fixed Effect Model (FEM), has already been determined.

The Return on Asset has a probability of 0.000 (see **Table 4**), which is below the threshold of 0.05. This indicates a significant negative effect on earnings management. The result also illustrates that when the presence of a female board of directors is moderated by Return on Assets, it holds significance for earnings management. As the number of female board of directors increases within a company, the company's overall performance, including Return on Assets, tends to improve. This positive influence can be attributed to the contributions made by female boards of directors in enhancing company performance. Consequently, as the board of directors gains benefits from the company's improved performance, there is less incentive to engage in earnings management actions (Astriah *et al.,* 2021).

Table 4. Female Board of Directors on Earnings Management Moderating by ROA

Variable	Coefficient	t-statistic	Prob.	Conclusion
Constant	0.034946	0.150362	0.8805	
Female Board of Directors	-0.017811	-0.235221	0.8141	Not significant
ROA	0.448766	1,367,879	0.0000	Significant
ROA X Female board of directors	-0.584775	-4,369,909	0.0000	Significant
Company Size	-0.001030	-0.128227	0.8980	Not significant
Leverage	0.000150	0.524585	0.6000	Not significant

Source: Processed secondary data (2023)

Arioglu's (2020) study shows that there is no significant relationship between female boards of directors in companies with earnings management. This is in line with the results of this study. The proportion of female board of directors has no significant effect on earnings management. Gloria and Emenike's (2018) research showed Return on Assets has a significant relationship with earnings management, this is because financial information becomes the basis of managers to determine earnings management actions.

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The results show that Return on Assets can positively influence earning management practices. The more the company has profit the more possibility of earnings management practice in the company. The findings are in line with agency theory, which centers on the conflict between principals and agents, where this theory predicts expected profits in the future for the conflicting interest (Putra, 2023). The results also show the moderate effect of ROA on the relationship between the female board of directors and earnings management. This proves the issue in this study where the female board of directors can influence the earnings management practice moderated by the profitability of the company. The female board of directors will not take earnings management actions unless a low return on assets can influence the female board of directors to take earnings management actions so that the company is considered good. The finding suggests that the return on assets of the company must remain stable and profitable to avoid the earnings management practices by the female board of directors. This is in line with Christiana's (2020) research which proves that to increase a company's profits, management often carries out activities that violate the rules, such as profit management actions to produce a good company image.

The control variables for the two hypotheses, namely firm size and leverage, are not found to be significant in earnings management. The result strongly highlights that earnings management actions can be influenced by supporting factors such as the company's Return on Assets. This phenomenon can be attributed to the following pattern: if a company's assets are low, management is more likely to resort to earnings management actions. Conversely, if the company's assets are substantial, there is less need for engaging in earnings management tactics within financial reports. Thus, the presence of a female board of directors within a company can positively impact company performance, as quantified by Return on Assets. This positive influence, in turn, contributes to minimizing the need for earnings management actions.

4. CONCLUSION

This study focuses on exploring the impact of female board of directors on earnings management and delves into the role of profitability as a mediating factor in enhancing the connection between female board of directors and earnings management. The research is conducted within the context of publicly listed companies on the Indonesian Stock Exchange. The findings reveal that the presence of a female board of directors alone does not exert a substantial influence on earnings management practices. In essence, merely having female directors on the board doesn't directly impact earnings management strategies. However, an interesting discovery emerges: the company's profitability plays a pivotal role in shaping the link between the female board of directors and earnings management. Specifically, higher company profitability appears to moderate or diminish the likelihood of female board of directors engaging in earnings management actions. According to previous research by Mnif and Cherif (2020) when a company performs well financially, the presence of a female board of directors will act as a balancer, thereby reducing the possibility of manipulative earnings management practices.

Companies that boast a higher representation of female board of directors exhibit a notable inclination towards diminishing the practice of earnings management, particularly when the company demonstrates strong performance. This correlation underscores a significant aspect of managerial consideration ensuring gender equality within the management team. By emphasizing gender diversity and ensuring a balanced representation of both men and women in leadership roles, companies can potentially foster a corporate environment that is less inclined to manipulate earnings. Moreover, this study presents a novel angle on the interaction

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between profitability and governance structure in moderating earnings management practices. While research on this specific topic remains relatively scarce, this study's findings contribute to the theoretical landscape by suggesting that the governance structure's influence on earnings management is contingent upon the company's performance.

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