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The Corporate Governance Mechanism on Earnings Management and Firm Performance

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Abstract

Corporate governance mechanism is a form of supervision of the company to run effectively and efficiently to improve firm performance and value. The supervision that corporate governance mechanism provide is to lesser the agency conflicts due the different interest between manager and owner such earnings management that is detrimental to shareholders. This study examines corporate governance as a supervisory mechanism that aims to improve firm performance, value and minimize earnings management. Then, we analyze the possibility that corporate governance mechanisms can improve firm's performance and value by controlling earnings management. Using data of banking companies from 2018-2019 then tested using partial least squares with the WarpPLS application, we found evidence that corporate governance mechanisms positively influence the company's financial performance. Corporate governance mechanism has a negative effect on firm value. Corporate governance mechanisms have a negative effect on earnings management. Then earnings management does not provide a mediating effect in the relationship of corporate governance with the company's financial performance and firm value.

Keywords: ***corporate governance; firm performance; firm value; earnings management***

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INTRODUCTION

The banking industry is one of the fastest-growing industries in Indonesia. Based on data from Financial Services Authority (2020), from 2016 to 2019, the banking industry's total assets increased by 27.24%. The increase in the banking industry in Indonesia indicates that banks in Indonesia have an efficient performance in managing companies. Good performance has a huge role in business development, where good performance would make it easier for the company to achieve its targets in the future. The performance and value of the company have a very close relationship with the welfare of the company's stakeholders, where the better and the faster the company generates profits, their interests would be fulfilled. Theoretically, many researchers are still looking for ways to improve company performance and value.

Corporate governance mechanism has a close relationship with the banking industry, because of the high pressure, strict regulations, and intervention from the government such as Bank Indonesia and the Financial Services Authority that always continue from time to time to supervise the banking industry. As an organization that manages public deposits, CG is the most important component in banking. CG is required to be able to guarantee the interests of stakeholders such as shareholders, investment managers, management, creditors, and employees (Khanifah et al., 2020). As many researchers have stated, that CG have positive relationship with firm performance such as in Rashid (2020), Singh & Kansil (2018), Yasser & Mamun (2017), and Doğan (2020) CG with ownership structure variable as a proxy shows the result that the ownership structure has a positive effect on company performance, and in other CG research, which measured by the size of the board of commissioners in Bansal & Sharma (2016) and Mishra & Kapil (2018), shows a positive influence on company performance. In Alqatamin (2018), and Bansal & Sharma (2016) with audit committee variable and Farouk & Hassan (2014), Wijaya (2020), and Afza & Nazir (2014) with audit quality found to have positive influence toward company performance. Then it can be said that tthe better the CG mechanism, the better the company's performance would be.

As a mechanism that guarantees the interests of the company's stakeholders, CG protects investors and stakeholders that they would be treated equally. Besides that, CG ensures that management would take action for the company's benefit. In addition, CG as a mechanism can be seen as a way for companies to monitor the behavior of company managers so that they do not make wrong decisions that might make the company lose money. This decision is expected to be the best decision in increasing the company's performance and value in the eyes of the capital market.

Even though, CG is still a challenge for policy makers regarding how the CG mechanism should be carried out to create corporate value and improve financial performance. Many researcher are still trying to formulate an optimal CG mechanism, that its implementation would not create new conflicts within the company that slow company performance, and lose focus to company's philosophical goal, namely seeking profit. Corporate Governance by Orazalin et al. (2016) described it would always change from time to time and evolve according to economic, social, and political developments to create a stable and growing business.

The CG mechanism refers to the rules of the game in running a company that connects various stakeholder interests through the supervisory and controlling function of the ownership structure, characteristics of the board of commissioners, audit committee, and external audit that ensures transparency in running the company. A suitable CG mechanism would reduce earnings management practices. Earnings management is a rotten accounting record waiting to be discovered. It is because earnings management presents reports that are not following reality and exploits accounting standards so that the company achieves performance targets (Xie et al., 2003). On the other hand, for managers, management can give messages or signals to the market about the company's performance (Siladjaja, 2019).

In the financial industry, especially banking, earnings management is a high-risk practice because banking is an industry that must ensure economic stability. If company managers hide information that has a high risk, it would create a bubble that would burst (Asghar et al., 2020). Earnings management practices lead to information asymmetry in the agency relationship between the principal and the agent, where the agent signals to the principal about the company's condition (Bukit & Nasution, 2015; Miko & Kamardin, 2015). However, the information is not per the actual condition of the company (Mahrani & Soewarno, 2018).

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Banking as a company not only has the responsibility of running the company in order to gain profits and improve company performance, but in the process the company must be able to prioritize ethical business values in creating company profits and value, one of which is not doing earnings management in order to achieve the target of the company performance. In this case, CG can effectively prevent earnings management activities carried out by managers to achieve certain performance achievements as in research Othman & Mersni (2015) and Pramithasari & Yasa (2017) found that the size of the board of commissioners and audit committee can prevent earnings management practices in companies.

In previous research, CG was studied with each element such as ownership structure, characteristics of the board of commissioners, audit committee and audit quality, it is very rare for CG to be studied as a single mechanism, to fill the gaps of previous studies, in this study CG would be manifested as a CG mechanism, and would be tested on the company's financial performance and firm Value (Kao et al., 2019; Rashid, 2020). Later in this study, the CG mechanism would be empirically proven to improve company performance by preventing earnings management practices in banking companies.

As the authors know, this study is the first to provide an overview of the CG mechanism in the banking industry, which empirically proves that preventing earnings management practices can improve company performance, both accounting-based and market-based performance in the banking industry in Indonesia. In the banking industry, earnings management is carried out by utilizing loan write-offs because they cannot be recovered. In the banking industry, loan write-off is an accrual policy with a relatively large amount of money compared to other industries that would impact income. This research would provide guidance on the role of GCG in the banking industry in suppressing earnings management practices and improving company’s performance and value.

Corporate governance mechanism can be a rule of play on how a company should be running in order to achieve company purpose to gain profit. Institutional ownership and foreign ownership as shareholders who have voting rights in determining company policies and directions are believed to control the running of the company and management in managing company assets in creating company wealth and increasing company value, as the results of research show Rashid (2020), Singh & Kansil (2018), and Yasser & Mamun (2017). They found that institutional and foreign ownership positively affected firm performance and value. The board of commissioners who have the task of supervising management in managing the company directors can act as a controller for the activities carried out by management. With the existence of an independent board of commissioners who have no relationship with the company, the role of the board of commissioners in supervising the company would be optimal because they have no other relation to the company except professional relation, which requires them to supervise the company. Empirically the existence of the board of commissioners and independent commissioners have a positive effect on the company's financial performance and firm Value (Bansal & Sharma, 2016; Bhagat & Bolton, 2019). The audit committee tasked with overseeing the effectiveness of the company's internal controls, and the auditor's duties were found to have an empirically positive influence on financial performance (Bansal & Sharma, 2016). In Farouk & Hassan (2014), Audit quality does not only symbolically affect financial performance but also makes a real contribution. It is confirmed by the research results of

Farouk & Hassan (2014), who found audit quality had a positive effect on the company's financial performance.
H_1: Corporate governance has a significant positive effect on financial performance.

In the previous literature, many researchers have proven that corporate governance can increase firm value, such as Doğan (2020), who found that the presence of institutional owners can increase firm value as they have a significant role in the stock market. Fitri et al. (2019) found evidence that foreign ownership can increase the company's value because of its ability to solve the problems that exist in the company. Mishra & Kapil (2018) found that the board of directors can be a good signal for the company's value. Afza & Nazir (2014) proves that the audit committee and audit quality can positively influence firm value because it provides confidence that they are getting authentic financial information.
H_2: Corporate governance has a significant positive effect on firm value.

Managers tend to do anything necessary to gain their personal interest, and one of them is earnings management. Earnings management is one of the ways used by managers to achieve their performance targets and to prevent managers from doing earnings management, good corporate governance is needed. In previous research, corporate governance has been proven to have a negative effect on earnings management, as in the research by Othman & Mersni (2015) and Pramithasari & Yasa (2017). Supervision and control of earnings management with corporate governance mechanisms would influence managers' decision-making when they want to exploit financial reporting so that they achieve the company's performance targets. Such actions are very detrimental to stakeholders because they do not get information per the company's actual situation. These conditions create conflicts between company managers and stakeholders. Corporate governance mechanisms such as institutional ownership, boards of commissioners, audit committees, and external auditors ensure agents work according to the expectations of principals and meet stakeholder expectations.
H_3: Corporate governance has a significant negative effect on earnings management.

Theoretically, if a company wants to improve its financial performance and firm value, it must have a suitable corporate governance mechanism. Good corporate governance would control agents so that they do not do anything that harms stakeholders because they want to fulfill their personal needs. Institutional ownership, foreign ownership of the board of commissioners, independent commissioners, audit committees, and audit quality that can act as supervisors for company activities can prevent management from happening.
H_4: Corporate governance has a significant positive effect on financial performance through earnings management

As a mechanism that reduces corporate earnings management, reducing earnings management actions with corporate governance mechanisms signals to the market that the company has good supervision and control. It is a positive signal for potential investors and investors who want to invest their capital. The corporate governance mechanism, which in this study is measured by institutional ownership, foreign ownership of the board of commissioners, independent commissioners, audit committees, and audit quality, would increase firm value of the corporate earnings management.

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H_5: Corporate governance has a significant positive effect on firm value through earnings management.

RESEARCH METHOD

The sample companies in this study are some companies listed on Indonesia Stock Exchange (IDX) and selected based on the purposive sampling method, namely data collection based on specific criteria. The criteria used the banking companies listed on the Indonesia Stock Exchange in a row from 2018-2019. These two years are used in this study because the banking industry experienced significant growth during these two years. The ROA in 2016 and 2017 was only 0.63%, while in 2018, it grew to 1,28% and 1,73% in 2019. In 2018-2019, the company published a complete annual report. Lastly, It provides data to support this research.

Variable Operational Definition

Financial performance

The financial performance variables used in this paper are return on equity (ROE), return on assets (ROA), and asset turnover. ROA reflects business profits and company efficiency in the utilization of total assets (Rashid, 2020). ROE reflects the business profits and efficiency of the company in utilizing its capital and the returns that shareholders can obtain (Rashid, 2020). ATO is the ratio of total income to total assets.
Where:
ROA: Net income/Total assets
ROE: Net income/Total equity
ATO: Total revenue/Total assets

The value of the company

Then the dependent variable is firm value using Tobin's Q and Price to Book Value (PBV) proxy. Tobin's Q reflects the company's value, which is calculated by combining accounting methods and the company's market (Doğan, 2020). Price to book value assesses the company based on how much the company's value in the capital market is compared to the company's book value (Arieftiara & Utama, 2018).

$$\text{Tobin's Q} = \frac{\text{Market Capitalization} + \text{Total Liabilities}}{\text{Total Assets}}$$

$$\text{Price to Book Value} = \frac{\text{Price Value}}{\text{Book Value}}$$

Corporate Governance Mechanism

Corporate governance in this study would be measured by the size of the board of commissioners, independent commissioners, institutional ownership, foreign ownership, audit committee size, and audit quality.

a. Board of Commissioners Size

The size of the board of commissioners referred in this study is the number of members of the board of commissioners in a company. The size of the board of commissioners is measured by calculating the total number of members of the board of commissioners in a company contained in the company's annual report and then transforming it into the form of a natural logarithm (Rashid, 2020).

b. **Independent Board of Commissioners**
Independent Commissioners are commissioners who have no relationship with the company except as professionals tasked with overseeing the company's performance. The proportion of independent commissioners is measured by the ratio between the number of independent commissioners and the total members of the board of commissioners.

c. **Institutional Ownership**
Institutional ownership is the proportion of shares owned by the institution at the end of the year. Institutional ownership includes ownership owned by banks, non-governmental organizations, pension fund managers, investment fund managers, both domestic and foreign. Institutional ownership is measured by the ratio of institutional ownership to total outstanding shares (Rashid, 2020).

d. **Foreign Ownership**
Foreign ownership is the proportion of share ownership in companies owned by foreign parties, either individually or in groups. Foreign ownership is the proportion of ownership owned by entities or individuals with foreign status. Foreign ownership is measured by the ratio of the number of shares owned by foreigners to the total outstanding shares.

e. **Audit Committee**
The audit committee is responsible for ensuring that the company's financial reporting is carried out with accounting standards and assisting the board of commissioners in supervising company managers. The audit committee in this study is measured by the company's total number of audit committee members (Alqatamin, 2018).

f. **Audit Quality**
As research that has been done by Bukit & Nasution (2015), if a company is audited by Big Four Public Accountants, namely Price Waterhouse Cooper (PWC), Deloitte Touche Tohmatsu, KPMG, Ernst & Young (E&Y) it would be given a score of 1, and if Big Four Public Accountants do not audit it then assigned with 0.

Earning Management

Earnings management in the banking industry is generally estimated using the model of Beaver & Engel (1996) because the model calculates the cost of loan losses (loan loss provision). Abbas (2018) explained that bank managers tend to manage earnings and manage capital by using the cost of loan losses to provide signals about the company's prospects in the future. Which measurements we would describe as follows:

$TA_{it} = NDA_{it} + DA_{it}$

TA_{it} is estimated with the regression equation:

$TA_{it} = \alpha + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1} + e_i$

Where:

COit:	loan charge offs (loans written off)
$LOAN_{it}$:	loans outstanding (loans in circulation)
NPA_{it}:	non-performing assets (productive assets that are non-performing), consisting of earning assets which based on their collectability, are classified into (a) substandard, (b) doubtful, and (c) loss.
NPA_{it+1}:	the difference between non-performing assets t+1 and non-performing assets t

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NDA_{it}: non-managed accruals
e_{i}: error

To get the coefficient value, all variables are divided by the coefficient by the book value of equity and loan loss reserves. DA_{it} is accruals under management (earnings management), TA is total accruals, and NDA is accruals under management, then:

$$NDA_{it} = \alpha + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1} + e_i$$

Then the discretionary accrual value can be obtained by:
$DA_{it} = TA_{it} - NDA_{it}$

Data Analysis Technique

Data analysis was carried out with descriptive analysis to provide the distribution of data and banking conditions in Indonesia in 2018-2019, followed by using the Structural Equation Modeling (SEM) Partial Least Square (PLS) method using the WarpPLS application. Partial least Square is considered a powerful analytical tool because it does not require assumptions as in the OLS method. The data are not required to be generally distributed in multivariate and multicollinearity problems on exogenous variables. It means that in this study, the number of samples is small, the potential for abnormal distribution of variables would not be a problem. Partial least Square assumes all variants are functional variants to explain so that this can avoid the indeterminacy factor.

In this study, the independent variable of corporate governance and the dependent variable (financial performance and firm value), and the mediating variable (earnings management) four were built with formative indicators. The formative indicator model was used because, generally, formative indicators are used in observable data, are quantitative, not in the form of perception. The formative data model does not have to have a common factor.

a. Assess the outer model or measurement model. In assessing the outer model in formative testing, first, check the collinearity by looking at the value of variance inflation factors (VIF), ideally below 3.3, following the rule of thumb. Both significance weight values are less than 0.05 (Kock, 2020).
b. Assessing the Inner Model or Structural Model. The structural model is evaluated by looking at the R-square to explain the effect of the exogenous latent variable whether it affects the endogenous latent variable (Ghozali & Latan, 2015). The R-square value is considered substantive if it is 0.25 weak, 0.5 moderate, and 0.75 strong, and more than 0.9 would be considered overfit (Hair et al., 2019).

Furthermore, the PLS model is evaluated by looking at the Q-Square predictive relevance for the constructed model. Q-Square predictive relevance represents the synthesis of the cross-validation and fitting functions of the observed variables and the estimation of the construct parameters. The Q-Square predictive relevance value greater than 0 indicates that the model has predictive relevance. The value is 0.02 weak, 0.15 moderate and 0.35 strong, while the Q-Square predictive relevance value is less than 0, indicating that the model lack predictive relevance (Ghozali & Latan, 2015). Decision making on the acceptance or rejection of the hypothesis is carried out with the following conditions:

a. View value inner weight of the relationship between latent variables. The weight value of the relationship must show a positive direction path coefficient with p-value < 0.10 for weakly significant; p-value < 0.05 for significant; and p-value < 0.01 for highly significant, then the hypothesis is accepted.
b. In determining the indirect effect in testing, the researchers used the method offered by Kock (2014), an alternative method in determining the mediating effect, by looking at the significance value. Indirect effect if the p-value < 0.10 is said to be weakly significant. If the p value < 0.05 then it is said to be significant P value < 0.01 highly significant, then it would be considered to be able to mediate.

The equation for the relationship between the inner model of this study can be written as:

$\eta EM = \xi CG + e$
$\eta FIN = \xi CG + \eta EM + e$
$\eta VAL = \xi CG + \eta EM + e$

Where:
η: Eta, endogenous latent variable
ξ: Ksi, exogenous latent variable
e: Error
EM: Earning Management
CG: Corporate Governance
FIN: Financial Performance
VAL: Firm Value

RESULTS AND DISCUSSION

The study results would first explain descriptive statistical data to provide an overview of banking data and conditions in Indonesia in 2018-2019.

Table 1. Descriptive Statistic

	N	Minimum	Maximum	Mean	Std. Deviation
Return on assets	54	-15.89	16.23	1.42	3.48
Return on equity	54	-89.03	60.79	5.39	17.81
Asset turnover turn	54	4.39	17.21	9.30	2.38
Tobin's Q	54	0.77	3.29	1.11	0.35
Price to book value ratio	54	0.17	4.58	1.26	0.84
Board of commissioners size	54	0.69	2.20	1.58	0.45
Proportion of independent board of commissioners	54	37.50	80.00	56.91	11.31
Institutional ownership	54	0.00	94.37	47.24	31.42
Foreign Ownership	54	0.00	98.40	33.63	36.11
Audit Committee	54	3.00	7.00	3.81	1.17
Audit Quality	54	0.00	1.00	0.59	0.50
Discretionary accruals	54	-0.0691	0.0122	-0.0026	0.0100
Valid N (listwise)	54				

Source: data processed by authors

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Outer Model

In the first test, the authors found two indicators of corporate governance that did not meet the test requirements because the VIF value was more than 3.3 and the significance of the weight was more than 0.05. We removed the two indicators and then retested them to solve this problem. Kock (2020) assesses the formative model testing by looking at the significance of the indicator, which should be below 0.05. Our study found evidence that the significance of our study weights was below 0.05 after retesting. So it can be said that the outer model in this test meets the requirements.

Inner Model

The R-square value of the test as outlined in table 5 R-square of financial performance (FIN) is 0.150, and this test model is less than 0.25. From this value, it can be concluded that the construct's variance can explain 15.0%, while other factors explain the remaining 85.0% outside of this study. The R-square value of firm value (VAL) is 0.079; this value can be concluded in this constructed model, the independent variable can explain 7.9%, while variables outside this study explain 82.1%, the last R-square of the effect CG on earnings management of 0.052 means that CG can explain earnings management of 5.2%, which mean there are 95.48% explained by other factors.

The Q-square value indicates that the model has predictive relevance. This study shows that the testing model for financial performance (FIN) has a Q-square of 0.160, which means the model has moderate predictive relevance because it has a value of Q2> 0.15. In the test model for firm value (VAL), Q-square is worth 0.110, which means the test model has weak predictive relevance because it has a value of Q2> 0.02, and the test of earnings management has a Q2 of 0.056 which means it has weak predictive relevance.

Table 2. R-Squared and Q-Squared

Information	R-square	Q-square
Financial Performance (FIN)	0.150	0.160
Company Value (VAL)	0.079	0.110
Earnings Management (EM)	0.052	0.056

Source: data processed by authors

Hypothesis Test

Table 6 is presented to make it easier to read the results of this study. The influence of corporate governance mechanism on financial performance has a path coefficient of 0.387 and p-value <0.001, and has a coefficient with a positive direction value means that in testing corporate governance on financial performance, it has a positive effect with highly significance, these results prove H_1 which states that corporate governance has a positive effect significant to financial performance, is accepted.

The influence of corporate governance on firm value has a path coefficient of -0.304 having a P-value of 0.008, which means that in testing corporate governance on firm value, corporate governance has a very significant negative effect on firm value; these results prove H_2, which states that corporate governance has a significant positive effect to the value of the company, was rejected.

Table 3. Hypothesis Test

Information	Path Coefficient	p-value	Conclusion
CG ~> FIN	0.387	<0.001	Sig Positive
CG ~> VAL	-0.304	0.008	Sig Negative
CG ~> EM	-0.227	0.037	Sig Negative
EM ~> FIN	-0.003	0.490	Not Sig
EM ~> VAL	-0.118	0.185	Not Sig
CG ~> EM ~> FIN	0.001	0.497	Not Sig
CG ~> EM ~> VAL	0.027	0.390	Not Sig

Source: data processed by authors

The influence of corporate governance on earnings management has a path coefficient of -0.227 and a P value of 0.037; this value means that corporate governance has a negative and significant effect because the p-value is below 0.05. Therefore, H_3 which states that corporate governance has a significant negative effect on earnings management, is accepted.

The influence of corporate governance on the company's financial performance through earnings management has a path coefficient of an indirect relationship of 0.001 and a p-value of 0.447. The p-value of the indirect effect is 0.497, which is greater than the criteria specified in this study, which means that it can be concluded that earnings management can be a mediating variable in the relationship between corporate governance and the company's financial performance. Therefore, H_4, which states that earnings management can mediate the influence of corporate governance on financial performance, is rejected.

Finally, the influence of corporate governance on the company's financial performance through earnings management has a path coefficient of an indirect relationship of 0.027 with a P-value of 0.390. The P-value of the indirect effect in this test is 0.390, and the value is greater than 0.10, which means that earnings management cannot mediate the relationship between corporate governance and firm value. Therefore, H_5 which states that earnings management can mediate the effect of corporate governance on firm value, is rejected.

The Effect of Corporate Governance on the Company's Financial Performance

The results show that the corporate governance mechanism has a very significant positive effect on the company's financial performance. These results indicate that the greater the number of commissioners, the better the supervision of banking companies in Indonesia. The proportion of independent commissioners who also have a role in overseeing the company's performance their existence as an independent party can minimize agency conflicts within the company because they do not have any interest in the company except their duty to supervise the company. The board of commissioners would supervise the work of directors so that they continue to work following the interests of stakeholders.

Institutional ownership and foreign ownership as one of the corporate governance mechanisms can directly influence directors because they have the right to vote on the direction in which the company would go. In other words, the owner would provide the vision and mission and what achievements are expected of them, and the owner of the company may also intervene in the work of company directors. In some instances, company

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owners can replace company directors because their performance does not match stakeholders' expectations. Therefore, directors would do their best so that their positions are not replaced because they can lose the benefits and incentives they get while serving as directors.

An audit committee with auditing and accounting knowledge in accordance with researchers' expectations can improve the company's financial performance. Their existence reduces the problems that may arise between management and stakeholders due to differences in views on the company's financial condition; the audit committee, as an extension of the board of commissioners, would help the board of commissioners to oversee the work of directors by providing information and a picture of the company per accounting standards. The audit committee can also be a liaison between management and external auditors because they can mediate conflicts between management and external audit. With fewer problems between management and others,

Then audit quality is one of the elements of the corporate governance mechanism that reviews the company's financial statements. Using the services of a public accountant who has a high reputation would reduce the opportunistic actions of managers that harm the company. Managers would focus on meeting the interests of company stakeholders because they do not want to have problems in the future. This research is in line with Alqatamin (2018), Bansal & Sharma (2016), Farouk & Hassan (2014), Rashid (2020), Singh & Kansil (2018), Wijaya (2020) and Yasser & Mamun (2017), and can be told that the corporate governance mechanism can improve the company's financial performance.

The Effect of Corporate Governance on Firm Value

Not as expected by the researcher, in this case, the results of the study indicate that the corporate governance mechanism has a negative effect on firm value. In this case, it is contrary to the results of previous studies such as Afza & Nazir, (2014); Doğan, (2020); Fitri et al., (2019); Mishra & Kapil, (2018) and Kurniansyah, Saraswati, & Rahman, (2021) which proves that corporate governance has a positive effect, in this study corporate governance actually has a negative effect.

In the context of the banking industry, corporate governance has a vital role in maintaining corporate value. Banking as an industry closely related to stakeholder trust requires the implementation of a good corporate governance mechanism. The banking industry would be very difficult to develop without high stakeholder trust. Corporate governance as a mechanism becomes the rules of the game for all parties involved, either directly or indirectly with the company, and ensures that no party feels disadvantaged in implementing corporate governance.

From the perspective of agency theory, initially, there was an agency conflict due to differences in interests between the principal and the agent employed. The existence of differences in interests impacts the company's inhibition in creating and increasing company value; therefore, excellent coordination is needed between all parties so that company value can grow (Panda & Leepsa, 2017). The agency problem is a susceptible issue because this issue would be directly captured by the stock market and reflected in the company's stock price, which means poor management of agency problems would result in a decrease in the company's value (McColgan, 2001).

In connection with this research, where the mechanism of corporate governance has a very significant negative influence on the company’s value, this can occur because of the inability of the corporate governance mechanism to reduce the agency problem within the company. The agency conflict creates inefficiency in daily operational activity and decisions, as seen by many market participants. The conflict occurred to create bad signaling toward a company, and the result of the bad signaling is a decrease in the company’s value. We can simply say that the board of commissioners, independent board of commissioners, institutional ownership, foreign ownership, audit committee, and external audit fails to grow firm value which is empirically proven in this study.

The Effect of Corporate Governance on Earnings Management

The corporate governance mechanism has a very vital role in reducing earnings management, as empirical evidence found that the corporate governance mechanism has a significant negative effect on earnings management, meaning that H3 is accepted. This finding proves that agency problems that arise can be reduced by improving corporate governance mechanisms. For example, the existence of institutional owners who have good supervisory skills because they have professional staff to oversee their investment funds, can be more careful in seeing the actions of managers who try to regulate company profits to deceive shareholders and stakeholders, owners can punish managers because they have voting rights. Then the controlling role of the board of commissioners as the hands of company owners who are directly involved in vital company decisions can prevent earnings management actions. The role of auditors, both internal and external to the company, can improve the quality of earnings presented in the financial statements because the financial statements present data per the actual situation. This research is in line with Mahrani & Soewarno (2018); Othman & Mersni (2015), and Pramithasari & Yasa (2017), who found that corporate governance has a negative effect on earnings management.

The Mediation Effect of Earnings Management on the Relationship of Corporate Governance with the Company's Financial Performance and Company Value

This is very interesting because the findings in this study prove that there is no indirect effect on the influence of corporate governance on the company's financial performance and firm value. These results indicate that although corporate governance mechanisms can reduce managers' earnings management practices, as shown in this study, this is not a reason for increasing financial performance and firm value.

This empirical evidence explains that corporate managers and corporate governance mechanisms have strategies to improve financial performance and firm value, not by reducing corporate earnings management practices. According to Alhadab & Own (2017), earnings management could be seen as a form of agency problem because managers try to manipulate the company's performance by using accounting policies in the company's financial statements, which is not in line with the expectations of stakeholders about how their agents should work.

A company is required to provide information about the company that is accurate and relevant to the actual conditions of the company. In terms of signaling theory, earnings management is one way for companies to provide information to the market about the condition of the company so that it seems as if the company has good performance in order better stock price so that managers would granted greater compensation for their

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achievement (Alhadab & Own, 2017). However, this method is contrary to the company's business ethics, where companies are required to provide information that is following reality to stakeholders, which act such as this is really harmful to many company stakeholders.

This study explains that earnings management control does not have an essential role in the relationship between corporate governance and company performance. This study contradicts Mahrani & Soewarno (2018), who found earnings management can mediate the effect of corporate governance relationships on company performance.

CONCLUSION

Corporate governance has become a debate among various researchers in the world on how to create an effective corporate governance mechanism to provide a competitive advantage to companies. Through this study, we found the results that corporate governance can have a positive influence on the company's financial performance. Meanwhile, in the tests conducted on the value of the company, we found that corporate governance has a negative influence; this indicates that there is a possibility of agency conflict shifting from what initially occurred between the principal and the agent, today it is also happening in the corporate governance mechanism which should be the hands of the principal. Supervise agent activities. Corporate governance was found to have a negative effect on earnings management, which means that corporate governance is very effective in suppressing the opportunistic actions of managers. Finally, earnings management cannot have an indirect effect on this test, with the effectiveness of corporate governance suppressing earnings management cannot improve financial performance or firm Value. For future research that wants to examine the same thing, it is better to add a control variable to provide better test results. Then the limitation of this study is the data collection that we do is quite limited because some companies have not published their financial statements yet; this limitation can be overcome by moving back to the year of observation.

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