



Earnings Quality: Corporate Governance Perception Index, Intellectual Capital and Spiritual Values

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This study was aimed to examine the contribution corporate governance, intellectual capital and spiritual values to earnings quality. The unit of analysis of this study was companies in Indonesia that go public which are included in Corporate Governance Perception Index, 39 data was obtained using purposive sampling during 2009–2013. The data was analyzed by using multiple regressions. The result is, although corporate governance, intellectual capital and spiritual values contributed simultaneously, it is known that spiritual values partially contributed negatively, because they have not many companies in Indonesia that concern in the implementation of spiritual values and are still oriented in financial factors as shown by positive contribution of structural value added to earnings quality.

Keywords: Corporate Governance, Intellectual Capital, Spiritual Values, Earnings Quality.

1. INTRODUCTION

Financial statement is the information needed by stakeholders in the making of decisions of their businesses. Financial report is a means of management responsibility.¹² Earnings are one of the information included in financial reports. Earnings that do not provide real information are considered as unqualified earnings that can mislead the users.¹⁴

To increase earnings quality, a corporate governance mechanism is required.^{2,4,11} The earnings quality aspect cannot be separated from agency conflicts. Based on agency theory,¹⁰ management as the company organizer has a broader access to internal information and company prospects than shareholders. This condition results in information asymmetry, in the form of data manipulation resulting in unqualified earnings.

There have been accounting scandals occurred in the United States, namely Enron Corp, Xerox Corp and World Com cases, where the companies bookkeepings were manipulated by marking up the earnings. This also happened in Indonesia, one of them is the earnings marked up by a pharmacy company, Kimia Farma.¹ This case resulted in unqualified earnings.^{8,19}

The unit of analysis of this study was companies that go public and are included in Corporate Governance Perception Index (CGPI), they are on a trusted and very a trusted company.²¹ Do companies included in CGPI have qualified earnings?

In addition to the need to maintain the earnings quality, company management needs to be adapted to the environmental

change. There is a shift in company orientation, from the conventional orientation that focuses on how to increase income to the value creation orientation, in which the ultimate goal is to increase the company capability in long term and responded by investors.^{4,5}

The motivation of this study was to examine the contribution of corporate governance, intellectual capital and spiritual values to earnings quality. The novelty of this study is spiritual values implemented by companies and is stated in annual report, hence it is secondary data. The spiritual values is one of the elements of intellectual capital.

2. LITERATURE REVIEW

Earnings quality compromised by managers will distort the benefit of accounting information, resulting in the misleading information of the real performance of the company and decision taking. As a result of adverse selection, a high return is required as a compensation for the risks of information.^{6,7}

This information distortion can be minimized by corporate governance.^{15,17} This research result has found an inverse correlation between corporate governance and earnings quality.

Ha₁: Corporate governance contributes to earnings quality.

A study on intellectual capital in various industries in Malaysia was proved to contribute to organization performance.⁴ Intellectual Capital affects positively to financial performance and company values.¹⁸

There has not any study result found that explicitly describes the relationship between intellectual capital and earnings quality.

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However, a key point is known that intellectual capital is able to create long term values, while qualified earnings are growing earnings where the development of company can be measured.

H_{a2} : Intellectual capital contributes positively on earnings quality.

3. RESEARCH METHOD

The unit analysis of this verification study was companies listed in Indonesia Stock Exchange included in Corporate Governance Perception Index (CGPI) during 2019–2013. Using purposive sampling, 45 companies data and 39 stock prices data were obtained, therefore the sample of this study was the data of 39 companies and stock prices.

Variables of this study consist of

- (1) corporate governance measured by CGPI score,
- (2) Intellectual capital measured by Value Added Capital Employed Ratio (VACA) formula, Value Added Human Capital Ratio (VAHU), Structural Capital Value Added Ratio (STVA) and the disclosure of spiritual values in annual report.
- (3) Earnings quality was measured by Earnings Response Coefficient:

$$CAR = \alpha_0 + \beta_1 UE_{it} + \beta_2 RT_{it} + \varepsilon$$

Where: CAR = Cumulated abnormal return; UE_{it} = Unexpected earnings for i company in t year; RT = annual return of i company in t period. β_1 = coefficient value of earnings respond.

CAR was calculated 5 days before, 5 days after and on the day when audited financial report was published. These 11 days are assumed as the effective time to assess market response.

This study used multiple regressions as statistical analysis method, with the following equation:

$$EQ = \alpha + \beta_1 CG_{it} + \beta_2 IC + \varepsilon$$

Where: EQ = Earnings Quality; CG = Corporate Governance; IC = Intellectual Capital; α = Constant; β_1, β_2 = Regression coefficient; ε = error.

Since multiple regressions were used, criteria of classic assumption must be met through normality, heteroscedasticity, and autocorrelation tests.

4. RESEARCH RESULT AND DISCUSSION

The result of descriptive analysis of research variables are as follow:

- (1) The mean of CGPI is 83.33; the enforcement of corporate governance in company is considered very trusted.
- (2) The mean of VACA is 0.875; the contribution of capital employed to value added of company is amounted to 0.875.
- (3) The mean of VAHU is 2.532; the contribution of every Rupiah invested in human capital to value added of company is amounted to 2.532.
- (4) The mean of STVA is 2.532; the contribution of every Rupiah invested in human capital to value added of company is amounted to 2.532.
- (5) The mean of STVA is -1.923 ; the number structural capital to generate 1 Rupiah as value added is amounted to $-1,923$, however STVA varies because mean < deviation standard.

Table I. Descriptive statistics.

	N	Minimum	Maximum	Mean	Std. deviation
CGPI	39	66.44	92.36	83.3382	6.89688
VACA	39	-1.98	3.07	0.8752	0.77380
VAHU	39	0.59	4.82	2.5323	1.07018
STVA	39	-114.95	3.70	-1.9231	18.61655
IC	39	-113.61	7.89	1.4844	19.03206
SV	39	0.18	1.00	0.4857	0.21504
ERC	39	-2.443	7.002	0.13178	1.547882
Valid N (listwise)	39				

- (6) The mean of IC is 1,484; the capability of company intellectual capital performance in value creation is amounted to 1.484, but the value varies among the companies included in the sample.
- (7) The mean of SV is 0.4857; the disclosure of spiritual values of company included in the CGPI category of 48.57, yet the value varies.

The result of regression analysis is shown in the following table:

From Table II, it is known that the value of adjusted R^2 is 0.360 with significance level of $0.004 \leq \alpha = 5\%$. This means, corporate governance, intellectual capital components (VACA; VAHU and STVA) and spiritual values can contribute simultaneously to earnings quality (ERC) by 36%, the rest is explained by other factors beyond variables studied.

The partial effect is described in Table III below:

In Table III, there is no IC, because it is an excluded factor in regression model. Partially, variables that affect earnings quality are:

- (a) CGPI contributed positively to earnings by 0.57%. Companies that belong to category of CGPI received positive responses from investors for enforcing fundamental governance. This study result resembles to the the study by Jiang et al.¹²
- (b) STVA contributed positively by 30.2% to earnings quality. The contribution of structure capital to value added of companies indicated the efficiency of capital use, thus resulted in value added. And hence received positive respond from investors.
- (c) SV contributed negatively to earnings quality with regression coefficient by -0.895 . This is indicated by varied data of ERC, and there is even negative data, as well as the awariness of companies to implement spiritual aspect is still around 48%. It can be said that investors did not respond those companies that implement spiritual values, although spiritual aspect is able to maintain fundamental and sustainability aspects.

Table II. Model summary^b.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson	
1	0.678 ^a	0.460	0.360	0.423124	1.313	
Model		Sum of squares	df	Mean square	F	Sig.
1 Regression		4.117	5	0.823	4.599	0.004 ^a
Residual		4.834	27	0.179		
Total		8.951	32			

Notes: ^aPredictors: (Constant), SV, CGPI, VAHU, STVA, VACA; ^bDependent variable: ERC.

Table III. Coefficients.

Model	Unstandardized coefficients		Standardized coefficients	t	Sig.
	B	Std. error	Beta		
1 (Constant)	-5.138	1.396		-3.679	0.001
CGPI	0.057	0.015	0.651	3.899	0.001
VACA	0.151	0.188	0.155	0.802	0.429
VAHU	0.068	0.080	0.130	0.857	0.399
STVA	0.302	0.114	0.505	2.655	0.013
SV	-0.895	0.367	-0.384	-2.438	0.022

Note: (a) Dependent variable: ERC.

(d) On the other hand, VACA and VAHU did not affect earnings quality. The investment incurred for the development of employees did not receive any respond from the investors as well as the capital invested. Therefore, the component of intellectual capital that really provides value creation in this study is STVA because it is related to company efficiency.

5. CONCLUSION AND RECOMMENDATION

The result of this study shows that the governance enforcement becomes the determinant factor of earnings quality, despite of its low contribution, investors still responded to it. On the other hand, STVA which is the component of IC was also one of the factors responded by investors, since structural capital in STVA indicates the creation of value added and business efficiency.

For further studies, it is recommended to develop this study using earnings quality as determinant factor to measure earnings persistency, since value creation in intellectual capital leads to long term value added, as well as earnings persistency as the predictor of future earnings.

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