

Independent Corporate Governance Organ Busyness, Earnings Quality, And Market Mispricing: Evidence From Indonesia

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Abstract: This research aims to give empirical evidence of the impact of independent corporate governance organ's busyness on earnings quality and market mispricing. This research utilized a sample of non-financial firms. It investigated the effect of independent corporate governance organ's busyness on earnings management and earnings persistence using random-effect panel data regression. Furthermore, the Mishkin Test was used to investigate market mispricing. The results showed that the busyness of independent commissioners and independent audit committees had a positive effect on increasing the magnitude of earnings management and a negative impact on the persistence of the accrual component but did not cause market confusion in assessing the company's earnings components. Furthermore, it was discovered that the degree of independent director's business did not influence the magnitude of earnings management. Instead, it resulted in poor persistence of the accrual component and market uncertainty in assessing earnings components.

Keywords: Corporate Governance; Busyness; Earnings Quality; Market Mispricing.

Abstrak: Penelitian ini bertujuan untuk memberikan bukti empiris dari pengaruh kesibukan organ *corporate governance* independen terhadap kualitas laba dan kekeliruan penilaian pasar. Penelitian ini menggunakan sampel perusahaan non-keuangan, dan menguji pengaruh dari kesibukan organ *corporate governance* independen terhadap manajemen laba dan persistensi laba menggunakan regresi panel data *random-effect*. Lebih lanjut, untuk menguji kekeliruan penilaian pasar, penelitian ini menggunakan Mishkin Test. Hasil pengujian menunjukkan bahwa tingkat kesibukan komisaris independen dan komite audit independen berpengaruh positif terhadap peningkatan besaran manajemen laba, dan berpengaruh negatif terhadap persistensi komponen akrual dari laba, namun tidak menyebabkan pasar mengalami kekeliruan dalam menilai komponen laba perusahaan. Selain itu ditemukan pula bahwa tingkat kesibukan direktur independen tidak berpengaruh terhadap besaran manajemen laba, namun menyebabkan rendahnya persistensi komponen akrual dari laba dan menyebabkan kekeliruan pasar dalam menilai komponen laba.

Kata kunci: Tata Kelola Perusahaan; Kesibukan; Kualitas Laba; Kekeliruan Penilaian Pasar.

INTRODUCTION

Financial statements are an essential source of information for investors in determining a company's performance, although profit figures are frequently used as the decision-making basis (Pratiwi et al., 2018). Suppose the manager's compensation is based on these profit figures. In that case, the manager will be incentivized to engage in aggressive and opportunistic earnings management by concealing actual earnings information and displaying the earnings information that managers want to show investors



(Silalahi and Warokka, 2023). This practice is hazardous since it can potentially decrease the accuracy of financial statement information, which may lead to investors being misled about the performance of the company in question (Almubarak et al., 2023). This, of course, can lead to investors making poor investment decisions. As a result, robust and effective corporate governance is required to guarantee that the company's management acts in the best interests of investors (Pramithasari and Yasa, 2016).

To monitor company management activities so as not to injure investors on the capital market, all countries require the existence of an independent corporate governance organ for each company listed on their respective stock exchanges (Ma and Khanna, 2016). An independent director and an audit committee are part of the independent corporate governance body. Indonesia has an extra independent corporate governance entity called the independent commissioner. Corporate governance organs play an essential function in the company (Oktavia, 2020). Because of its independent nature, this organ is more objective in carrying out its duties and prioritizing the interests of wider stakeholders (Fuji et al., 2016). As independent individuals, they will ensure that their presence and performance are unaffected by other parties, particularly the company's management. The organization designates an impartial corporate governance organ to monitor the performance of the executive suite. Consequently, they will pursue shareholder interests by increasing shareholder value (Fuji et al., 2016). Several studies have proven that the presence of an independent corporate governance organ can increase company value (Oktavia, 2020).

Suppose these organs have too many tasks because they hold multiple positions at other companies or institutions. In that case, they will neglect their responsibility to monitor the company, which can result in low-quality profit figures because they are unaware that the company's management has engaged in aggressive earnings management (Oktavia, 2020). Suppose the company's earnings management activities become excessively aggressive due to a lack of supervision from independent corporate governance organs. In that case, the overly aggressive earnings management activities will result in low earnings persistence (Asogwa et al., 2019). (Oktavia et al., 2019) indicate low earnings persistence and low earnings quality. Investors will only make a mistake when evaluating the earnings component of companies with high levels of activity of independent corporate governance organs if they are aware that a high level of activity of independent corporate governance organs can result in poor quality corporate earnings. This study seeks to investigate the effect of the level of activity of independent corporate governance organs on earnings management activity, earnings persistence, and market mispricing based on the description provided above.

This research has numerous contributions. First, this research is the first study to examine the association between the level of activity of independent corporate governance organs and market valuation errors. Second, this study fills an absence in the literature discussing the effect of the activity of independent corporate governance organs on earnings quality (which is proxied by discretionary accruals and earnings persistence) and on market mispricing. Research on the activities of the corporate governance organs is still diverse. It requires empirical evidence to determine if the activities of the corporate governance organs impact the company. Third, this research is expected to provide input to the capital market authority in deciding whether it is necessary to limit the maximum number of jobs or positions that independent corporate governance organs can hold for these organs to be more effective in monitoring company activities.



THEORETICAL REVIEW

The effect of the busyness level of independent corporate governance organs on earnings management. Excellent and effective corporate governance is expected to decrease aggressive earnings management strategies that may negatively impact investors (Purbawangsa et al., 2019). Previous research has assessed the relationship between corporate governance and earnings management activities (Orazalin, 2019; Pramithasari and Yasa, 2016). There needs to be more research relating the level of activity of independent corporate governance organs to earnings management. Existing study findings present contradictory data (Mukherjee and Sen, 2022). Several studies have concluded that busy corporate governance organs are associated with low corporate value and ineffective oversight (Trinugroho et al., 2022), while other studies provide conflicting evidence (Tan et al., 2019).

Organizations with overburdened independent corporate governance institutions tend to have worse corporate governance quality. This finding is also supported by more recent research in the Indonesian setting. (Trinugroho et al., 2022) determined that a busy board of commissioners reduces company performance, particularly for big corporations and state-owned companies that demand greater scrutiny from the board of commissioners. Companies with active independent corporate governance organs are less likely to receive a qualified audit opinion due to their lack of management supervision and increased earnings management practices (Ferris and Liao, 2019). According to the previous description, the following hypothesis is proposed:

H1_a: The busyness level of the independent commissioners has a positive effect on the company's earnings management.

H1_b: The busyness level of the independent directors has a positive effect on the company's earnings management.

H1_c: The busyness level of the independent audit committee has a positive effect on the company's earnings management.

The effect of the busyness level of independent corporate governance organs on earnings persistence. Investors utilize current revenues to forecast the next earnings performance of a company. Sun (2020) demonstrates that profits are persistent if the company's current profit level is replicated at the same level in the next financial term. Consequently, revenue with a high level of consistency will provide more accurate predictions of future revenue results. Companies with consistent profitability have higher long-term profits (Oktavia et al., 2019). Earnings management operations conducted via excessively aggressive accrual rules due to a lack of oversight by independent corporate governance organs might result in poor earnings persistence (Asogwa et al., 2019), particularly the persistence of the accrual component of earnings. Low earnings persistence indicates low earnings quality (Oktavia et al., 2019). The use of extreme discretionary accruals as an earnings management technique by company management causes the accrual component of earnings to become less persistent (Rountree et al., 2023). The substantial amount of discretionary accruals represents a less consistent component of profits (particularly the accrual component of earnings) and the poor quality of earnings declared by corporations. The discretionary accrual component is derived from



management actions unrelated to operational operations. Thus, it is not unexpected that this component would negatively impact the organization's long-term profitability (Oktavia et al., 2019). Furthermore, the severe accrual components tend to have more estimating mistakes that must be addressed or reversed in the subsequent period. The accrual model residuals represent managerial discretion or estimating mistakes (Boachie and Mensah, 2022).

This study believes that the high activity of independent corporate governance organs will cause these organs to be negligent in supervising company management, resulting in increased use of discretionary accruals as a means of earnings management, lowering the quality of reported earnings and making the accrual component of a company's profit less persistent. As a result, less consistent profits may not be a strong predictor of long-term sustainable earnings in the future (Oktavia et al., 2019). Moreover, (Ferris and Liao, 2019) also found that busy independent audit committees generate lower earnings quality. This occurs because the active independent audit committee is less able to provide careful supervision of management activities within the company. Although (Ferris and Liao, 2019) solely studied the impact of the audit panels' busyness on earnings quality, they did look at a broader spectrum of independent corporate governance organs, such as independent commissioners and independent directors. Based on the preceding description, the following hypothesis is suggested:

H2_a: The independent commissioners' busyness level negatively affects the persistence of the accrual component of the company's earnings.

H2_b: The busyness level of the independent directors has a negative effect on the persistence of the accrual component of the company's earnings.

H2_c: The independent audit committee's busyness level negatively affects the persistence of the accrual component of the company's earnings.

The effect of the busyness level of the independent corporate governance organs on market mispricing. Very few studies have measured the impact of company governance characteristics on market mispricing. (Sun, 2020) discovered that effective corporate governance weakens market mispricing. On the other hand, (Martins et al., 2021) argued that, in emerging markets, external monitoring and the ability level of investors is a potentially significant mechanism for preventing erroneous market judgments. This study will examine the impact of independent corporate governance organs' activity (as a proxy for corporate governance procedures) on market mispricing. Independent corporate governance organs with sufficient time to monitor the firm will be more focused on overseeing its management actions, resulting in a higher quality of the profits it monitors (Ferris and Liao, 2019; Trinugroho et al., 2022). On the other hand, companies with a high degree of busyness of independent corporate governance organs will influence the poor quality of profit numbers published in the company's financial statements. Investors will make mistakes in assessing the components of earnings in companies with high levels of activity of independent corporate governance organs if they do not recognize that high levels of activity of independent corporate governance organs can lead to low quality of earnings reported.

In addition to lowering profit quality, aggressive earnings management is connected with increased information asymmetry and decreased financial report transparency (Muhi



and Mounir, 2023). When there is a significant data asymmetry, stakeholders need more resources or access to pertinent information to supervise managers' actions, which increases earnings management practices. If the company's management has an information edge and access to more private information, they would often maximize earnings to attract new investors. As a result, they have incentives to cover up possible issues in the organization and tend to manipulate results, resulting in poor-quality reported earnings (Muhi and Mounir, 2023). With growing information asymmetry, earnings management operations, including discretionary accruals, create additional opportunities for managers to conceal negative news and mislead investors. According to this research, limiting the busyness of independent corporate governance organs may boost financial report transparency and minimize information asymmetry. Companies with a low level of busyness in independent corporate governance organs will be more transparent in disclosing information than companies with a high level of activity in independent corporate governance organs, giving investors more information for decision-making and, as a result, lowering market mispricing. The following study hypothesis was formed based on the prior description:

H3: Earnings expectations embedded in the stock returns reflect the differences in the persistence of the earnings component more accurately as the busyness level of the independent corporate governance organs decreases

METHODS

Sample Selection and Data Source. Annual data reports, reports on finances, and stock prices originated from the Thomson Reuters Datastream Pro data centre. This research period they started from 2016 to 2021, with a note that the 2021 period was used to calculate the variables $EARN_{it+1}$ and $RETURN_{it+1}$. At the same time, the sample used as the research object was firms in the non-financial industry listed on the Indonesia Stock Exchange (IDX).

Research Model. To test the H1 hypothesis, this study employed the following research model:

$$ABS_DACC_{it} = \alpha_0 + \alpha_1 BUSYCOM_{it} + \alpha_2 BUSYDIR_{it} + \alpha_3 BUSYCOMMITTEE_{it} + \alpha_4 SIZE_{it} + \alpha_5 ROA_{it} + \alpha_6 DTA_{it} + \varepsilon_{it} \quad (1)$$

H1a is acceptable if α_1 greater than 0; H1b is acceptable if α_2 greater than 0; H1c is acceptable if α_3 greater than 0.

ABS_DACC_{it} is the absolute value of discretionary accruals; $BUSYCOM_{it}$ is the busyness level of the independent commissioner; $BUSYDIR_{it}$ is the busyness level of the independent director; $BUSYCOMMITTEE_{it}$ is the busyness level of the audit committee; $SIZE_{it}$ measured by the natural logarithm of total assets; ROA_{it} is a return on investments; and DTA_{it} is total debt to total assets.

The accruals component in this study has been divided into accruals that are discretionary and accruals that are not discretionary to calculate the differences in the stability of the earnings element and test the differences in the stability of the earnings element. A one-year-ahead earnings regression model was created using earlier research models, represented by Equation (2) (Oktavia et al., 2019), and used to test hypothesis H2. The H2 hypothesis was developed to test whether the activity level of the independent



corporate governance organs affects the persistence of the accrual element of corporate earnings.

$$\begin{aligned}
 \text{EARN}_{it+1} = & \beta_0 + \beta_1\text{CFO}_{it} + \beta_2\text{NDAC}_{it} + \beta_3\text{DACC}_{it} + \beta_4\text{BUSYCOM}_{it} + \beta_5\text{BUSYDIR}_{it} + \\
 & \beta_6\text{BUSYCOMMITTEE}_{it} + \beta_7\text{CFO}*\text{BUSYCOM}_{it} + \beta_8\text{NDAC}*\text{BUSYCOM}_{it} + \\
 & \beta_9\text{DACC}*\text{BUSYCOM}_{it} + \beta_{10}\text{CFO}*\text{BUSYDIR}_{it} + \beta_{11}\text{NDAC}*\text{BUSYDIR}_{it} + \\
 & \beta_{12}\text{DACC}*\text{BUSYDIR}_{it} + \beta_{13}\text{CFO}*\text{BUSYCOMMITTEE}_{it} + \\
 & \beta_{14}\text{NDAC}*\text{BUSYCOMMITTEE}_{it} + \beta_{15}\text{DACC}*\text{BUSYCOMMITTEE}_{it} + \varepsilon_{it} \dots\dots (2)
 \end{aligned}$$

H2a is acceptable if β_8 less than 0 and β_9 less than 0; H2b is acceptable if β_{11} less than 0 and β_{12} less than 0; H2c is acceptable if β_{14} less than 0 and β_{15} less than 0. EARN_{it+1} is income from continuing operations in year $t+1$; CFO_{it} is cash flow from operation; DAC_{it} is non-discretionary accrual; and DACC_{it} is discretionary accrual.

To test the H3 hypothesis, this study employed the Mishkin Test (Oktavia et al., 2019). This model has been widely used to estimate market mispricing (Oktavia et al., 2019; Sun, 2020). This research employed the following research model to measure if the amount of activity of independent company governance organizations has an impact on market valuation mistakes:

$$\begin{aligned}
 \text{EARN}_{it+1} = & \gamma_0 + \gamma_1\text{CFO}_{it} + \gamma_2\text{NDAC}_{it} + \gamma_3\text{DACC}_{it} + \gamma_4\text{CFO}_{it}*\text{BUSYCOM}_{it} \dots(3) \\
 & + \gamma_5\text{NDAC}_{it}*\text{BUSYCOM}_{it} + \gamma_6\text{DACC}_{it}*\text{BUSYCOM}_{it} + \\
 & \gamma_7\text{CFO}_{it}*\text{BUSYDIR}_{it} + \gamma_8\text{NDAC}_{it}*\text{BUSYDIR}_{it} + \\
 & \gamma_9\text{DACC}_{it}*\text{BUSYDIR}_{it} + \gamma_{10}\text{CFO}_{it}*\text{BUSYCOMMITTEE}_{it} + \\
 & \gamma_{11}\text{NDAC}_{it}*\text{BUSYCOMMITTEE}_{it} + \\
 & \gamma_{12}\text{DACC}_{it}*\text{BUSYCOMMITTEE}_{it} + \theta_{it+1}
 \end{aligned}$$

$$\begin{aligned}
 \text{RETURN}_{it+1} = & \alpha + \beta (\text{EARN}_{it+1} - \gamma_0 + \gamma_1\text{CFO}_{it} + \gamma_2\text{NDAC}_{it} + \gamma_3\text{DACC}_{it} + \dots(4) \\
 & \gamma_4\text{CFO}_{it}*\text{BUSYCOM}_{it} + \gamma_5\text{NDAC}_{it}*\text{BUSYCOM}_{it} + \\
 & \gamma_6\text{DACC}_{it}*\text{BUSYCOM}_{it} + \gamma_7\text{CFO}_{it}*\text{BUSYDIR}_{it} + \\
 & \gamma_8\text{NDAC}_{it}*\text{BUSYDIR}_{it} + \gamma_9\text{DACC}_{it}*\text{BUSYDIR}_{it} + \\
 & \gamma_{10}\text{CFO}_{it}*\text{BUSYCOMMITTEE}_{it} + \\
 & \gamma_{11}\text{NDAC}_{it}*\text{BUSYCOMMITTEE}_{it} + \\
 & \gamma_{12}\text{DACC}_{it}*\text{BUSYCOMMITTEE}_{it}) + \varepsilon_{it+1}
 \end{aligned}$$

H3 is acceptable if $\gamma_4 \neq \gamma^*_4$; $\gamma_5 \neq \gamma^*_5$; $\gamma_6 \neq \gamma^*_6$; $\gamma_7 \neq \gamma^*_7$; $\gamma_8 \neq \gamma^*_8$; $\gamma_9 \neq \gamma^*_9$; $\gamma_{10} \neq \gamma^*_{10}$; $\gamma_{11} \neq \gamma^*_{11}$; $\gamma_{12} \neq \gamma^*_{12}$

Equation (3) is a forecasting equation which calculates the forecasting coefficient to predict earnings one year in the future, while equation (4) is a valuation equation which calculates the valuation coefficient.

Definition of Variables. This study employed the absolute value of discretionary accruals to measure the magnitude of earnings management (ABS_DACC). Total accruals (ACC) are split into components of discretionary accruals (DACC) and non-discretionary accruals (NDAC). This model was preferred because it has the best ability to detect earnings management and has been widely used to detect earnings management by various studies (Collins et al., 2017). The non-discretionary accrual component is the fitted value of the model (5), while the discretionary accrual component is the model's residual value (5).



$$\frac{ACC_{it}}{TA_{it-1}} = \alpha (1/TA_{it-1}) + \alpha_1((\Delta REV_{it} - \Delta REC_{it})/TA_{it-1}) + \alpha_2(PPE_{it}/TA_{it-1}) + \alpha_3ROA_{it} + \varepsilon_{it} \quad \dots(5)$$

ACC_{it} is total accruals, calculated from income from continuing operations in year t subtracted by the operating cash flow in year t; TA_{it-1} is lagged total assets; ΔREV_{it} is change in revenue from year t-1 to year t; ΔREC_{it} is change in receivables from year t-1 to year t; PPE_{it} is property, plant and equipment in year t; and ROA_{it} is net income in year t divided by total asset in year t-1.

Stock return (RETURN) was determined using Cumulative Abnormal Return and Market Adjusted Return over 12 months ending in the third calendar month after the financial year's period ended (from April in year t to March in year t+1). Furthermore, the workload of independent commissioners (BUSYCOM) was evaluated utilizing the average of the number of positions held by independent commissioners, the busyness level of independent directors (BUSYDIR) was calculated using the average of the number of positions handled by independent directors, and the busyness level of the independent audit committee (BUSYCOMMITTEE) was calculated using the average of the number of positions held by the independent audit committee.

RESULTS

Descriptive Statistics. Table 1 displays the descriptive statistics obtained from the data in this investigation. EARN_{t+1} represents a positive average value. This means the sample company's earnings increased on average throughout the t+1 period. The average positive number for the CFO is also provided, indicating that the average sample company had a positive cash flow. The busyness level of independent corporate governance organs has a minimum value of 0. This suggests that some corporations had distinct corporate governance organs with no concurrent roles, either internal or external to the organization. Independent commissioners (BUSYCOM), with a maximum score of 7, were one of the three independent corporate governance institutions with the highest average level of busyness. Meanwhile, the independent director (BUSYDIR) had the lowest level of busyness, with an average score of 1.069.

Table 1. Descriptive Statistics

| Variable | n | Mean | Std. Dev. | Min | Max |
|-----------------------|------|--------|-----------|--------|--------|
| EARN _{t+1} | 1631 | 0.055 | 0.129 | -0.829 | 1.036 |
| RETURN _{t+1} | 1631 | 0.127 | 0.790 | -2.745 | 8.308 |
| CFO | 1631 | 0.058 | 0.183 | -1.964 | 4.148 |
| NDAC | 1631 | 0.007 | 0.194 | -3.042 | 4.130 |
| DACC | 1631 | -0.005 | 0.154 | 2.979 | 1.558 |
| ABS_DACC | 1713 | 0.072 | 0.077 | 0.003 | 0.448 |
| BUSYCOM | 1713 | 2.718 | 1.829 | 0.000 | 7.000 |
| BUSYDIR | 1713 | 1.069 | 0.916 | 0.000 | 3.000 |
| BUSYCOMMITTEE | 1713 | 2.463 | 1.426 | 0.000 | 5.750 |
| SIZE | 1713 | 18.915 | 1.509 | 13.923 | 21.125 |
| ROA | 1713 | 0.050 | 0.099 | -0.413 | 0.257 |



| | | | | | |
|-----|------|-------|-------|-------|-------|
| DTA | 1713 | 0.272 | 0.187 | 0.000 | 0.644 |
|-----|------|-------|-------|-------|-------|

Source: Processed research data, 2023

Correlation Matrix. The Pearson Correlation test was used to confirm that the data in this research were free of correlation issues. Because this research employed numerous distinct models, the two tests will be presented in two tables, as illustrated in **Tables 2** and **3**. **Tables 2** and **3** show that both models were devoid of multicollinearity issues. A Pearson correlation threshold of 0.800 was used in this research for correlation concerns. In **Table 3**, the highest coefficient was seen in the BUSYCOMMITTEE variable, which had a significant correlation with the BUSYCOM variable of 0.699. The strong correlation between the two arose because the independent audit committee was also part of the company's board of commissioners.

Table 2. Pearson Correlation test for model (1)

| Variables | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|-------------------|----------------------|--------------------|---------------------|----------------------|--------------------|----------------------|-------|
| (1) ABS_DACC | 1.000 | | | | | | |
| (2) BUSYCOM | 0.038 (0.119) | 1.000 | | | | | |
| (3) BUSYDIR | 0.019 (0.429) | 0.332** (0.000) | 1.000 | | | | |
| (4) BUSYCOMMITTEE | 0.019 (0.437) | 0.699** (0.000) | 0.249** (0.000) | 1.000 | | | |
| (5) SIZE | -0.135*** (0.000) | 0.148** (0.000) | 0.038 (0.116) | 0.309*** (0.000) | 1.000 | | |
| (6) ROA | 0.103*** (0.000) | 0.038 (0.116) | 0.068** (0.005) | 0.078 (0.001) | 0.226** (0.000) | 1.000 | |
| (7) DTA | -0.026 (0.281) | -0.034 (0.159) | -0.10*** (0.000) | -0.069*** (0.004) | 0.104** (0.000) | -0.229*** (0.000) | 1.000 |

***Significant at 1 percent; ** Significant at 5 percent; * Significant at 10 percent.

Source: Processed research data, 2023

Table 3 illustrates the association of the variables used in estimating model (2). The CFO variable was positively and significantly related to $EARN_{t+1}$. The greater the operational cash flow in the present period, the higher the profit in the next period. The NDACC variable was likewise shown to have a positive and substantial connection with $EARN_{t+1}$. That is, the higher the non-discretionary accruals, the greater the following period's profit. **Table 3** further shows that the DACC variable had a negative and substantial relationship with $EARN_{t+1}$. That is, the higher the discretionary accruals, the lower the following period's profit. **Table 3** demonstrates that the NDACC and DACC variables were negatively related to CFO. The negative connection between the two variables suggested income smoothing (Oktavia et al., 2019). When accruals are utilized to level out periodic fluctuations in cash flows, the relationship between accruals and cash flows grows negative. The level of activity of the independent corporate governance organs (BUSYCOM, BUSYDIR, and BUSYCOMMITTEE), only BUSYCOMMITTEE has a significant positive correlation with $EARN_{t+1}$.



Table 3. Pearson Correlation test for model (2)

| Variables | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|-------------------------|----------------------|---------------------|----------------------|---------------------|---------------------|---------------------|-------|
| (1) EARN _{t+1} | 1.000 | | | | | | |
| (2) CFO | 0.360*** (0.000) | 1.000 | | | | | |
| (3) NDAC | 0.249*** (0.000) | - (0.000) | 1.000 | | | | |
| (4) DACC | -0.117*** (0.000) | - (0.000) | -0.479*** (0.000) | 1.000 | | | |
| (5) BUSYCOM | 0.032 (0.194) | 0.010 (0.675) | 0.023 (0.361) | 0.017 (0.499) | 1.000 | | |
| (6) BUSYDIR | 0.019 (0.436) | 0.009 (0.715) | 0.043* (0.082) | -0.016 (0.521) | 0.270*** (0.000) | 1.000 | |
| (7) BUSYCOMMITTEE | 0.087*** (0.000) | 0.092*** (0.000) | 0.058** (0.020) | -0.052** (0.035) | 0.685*** (0.000) | 0.212*** (0.000) | 1.000 |

***Significant at 1 percent; ** Significant at 5 percent; * Significant at 10 percent.

Source: Processed research data, 2023

Regression Results. Table 4 shows that the independent corporate governance organs' activity level that significantly influences earnings management's magnitude is the independent commissioner's busyness level (BUSYCOM) and the busyness level of the independent audit committee (BUSYCOMMITTEE). The coefficients of the two variables showed positive signs (0.001 and 0.003). These data suggest that the workload of a business's independent commissioners and independent committee panels increases the magnitude of earnings management in that company. These results support the hypotheses **H1_a** and **H1_c**. It has been empirically demonstrated that the BUSYDIR variable had no significant effect on the magnitude of the company's earnings management.

Table 4. Regression results – hypothesis H1

| Variable | Predicted sign | Coefficient | t-statistic | Sig. |
|-------------------------|----------------|-------------|-------------|-------|
| Intercept | +/- | ***0.239 | 5.14 | 0.000 |
| BUSYCOM | + | **0.001 | 1.71 | 0.044 |
| BUSYDIR | + | 0.000 | 0.07 | 0.473 |
| BUSYCOMMITTEE | + | **0.003 | 1.68 | 0.046 |
| SIZE | - | ***-0.011 | -3.77 | 0.000 |
| ROA | + | ***0.116 | 5.56 | 0.000 |
| DTA | + | 0.013 | 0.89 | 0.188 |
| N | | 1713 | | |
| R ² | | 0.516 | | |
| Wald chi ² | | 9.34 | | |
| Prob > chi ² | | ***0.000 | | |

***Significant at 1 percent; ** Significant at 5 percent; * Significant at 10 percent.

Source: Processed research data, 2023

Furthermore, this study tested the second hypothesis, namely the effect of the busyness level of independent corporate governance organs on the persistence of the

accrual component of earnings. **Table 5** shows the results of testing the H2 hypothesis from this study. From the table, it is known that the variables NDAC*BUSYCOM and DACC*BUSYCOM had negative and significant coefficients. This means that the workload of the independent commissioners had a negative impact on the persistence of the accrual component of earnings, both the non-discretionary accrual component and the discretionary accrual component. These findings indicated that the higher the level of activity of the independent commissioners, the lower the ability of the accrual component of earnings to predict company profits in future periods. Thus, the research hypothesis **H2a** was accepted.

Table 5. Regression results – hypothesis H2

| Variable | Predicted sign | Coefficient | t-statistic | Sig. |
|-------------------------|----------------|-------------|-------------|-------|
| Intercept | | 0.031 | ***3.89 | 0.000 |
| CFO | | 0.443 | ***10.98 | 0.000 |
| NDAC | | 0.498 | ***11.40 | 0.000 |
| DACC | | 0.484 | ***8.62 | 0.000 |
| BUSYCOM | | -0.003 | *-1.42 | 0.078 |
| BUSYDIR | | -0.001 | -0.59 | 0.279 |
| BUSYCOMMITTEE | | 0.003 | 0.96 | 0.169 |
| CFO*BUSYCOM | | 0.013 | 0.71 | 0.238 |
| NDAC*BUSYCOM | | -0.041 | ***-2.52 | 0.006 |
| DACC*BUSYCOM | | -0.029 | *-1.43 | 0.077 |
| CFO*BUSYDIR | | 0.051 | ***2.77 | 0.003 |
| NDAC*BUSYDIR | | -0.024 | *-1.59 | 0.056 |
| DACC*BUSYDIR | | -0.032 | *-1.43 | 0.077 |
| CFO*BUSYCOMMITTEE | | 0.021 | 0.93 | 0.176 |
| NDAC*BUSYCOMMITTEE | | -0.030 | *-1.45 | 0.074 |
| DACC*BUSYCOMMITTEE | | -0.043 | *-1.54 | 0.062 |
| N | | 1631 | | |
| R ² | | 0.372 | | |
| Wald chi ² | | 860.78 | | |
| Prob > chi ² | | ***0.000 | | |

***Significant at 1 percent; ** Significant at 5 percent; * Significant at 10 percent.

Source: Processed research data, 2023

NDAC*BUSYDIR and DACC*BUSYDIR likewise exhibited negative and significant coefficients, as seen in **Table 5**. That is, the workload of independent directors lowered the durability of earnings accrual components, including non-discretionary and discretionary accrual. As a result, the study hypothesis **H2b** was accepted. Furthermore, **Table 5** also shows that the NDAC*BUSYCOMMITTEE and DACC*BUSYCOMMITTEE variables had negative and significant coefficients. These findings indicated that the higher the workload of the independent audit committee, the lower the persistence of the accrual component of earnings. Based on these findings, it can be inferred that the **H2c** hypothesis was accepted.

Mispricing Test Results. **Table 6** shows the results of the market mispricing test on the components of the company's profit. It is visible from the table that the coefficient γ_1 was not substantially different from the coefficient γ^*1 (due to the significance value, which was higher than the 1 per cent significance level). These findings suggest that the market was not mistaken in measuring the stability of the operating cash flow component in the sample firms. **Table 6** depicts that the coefficients γ_2 and γ_3 were significantly different from the coefficients γ^*2 and γ^*3 , indicating that the market had experienced a

mistake in assessing the accrual component of earnings (both discretionary accrual components and non-discretionary accrual components).

Table 6 it is also found that the coefficients γ_4 , γ_5 , and γ_6 were not significantly different from the coefficients γ^*_4 , γ^*_5 , and γ^*_6 . This finding indicated that the busyness level of independent commissioners did not cause the market to experience a mistake in assessing the persistence of earnings components, namely operating cash flow components, non-discretionary accruals, and discretionary accruals. Furthermore, Table 6 also shows that the coefficients γ_{10} , γ_{11} , and γ_{12} were not significantly different from the coefficients γ^*_{10} , γ^*_{11} , and γ^*_{12} . These findings indicated that the busyness level of the independent audit committee did not cause the market to experience a mistake in assessing the persistence of the operating cash flow component, the non-discretionary accrual component, and the discretionary accrual component.

Table 6 shows that the coefficients γ_7 , γ_8 , and γ_9 were significantly different from the coefficients γ^*_7 , γ^*_8 , and γ^*_9 . In addition, it can also be seen that CFO*BUSYDIR, NDAC*BUSYDIR, and DACC*BUSYDIR had valuation coefficients (see coefficients γ^*_7 , γ^*_8 , and γ^*_9) which were higher than forecast coefficient values (see γ^*_7 , γ^*_8 , and γ^*_9). These findings indicated that the busyness level of independent directors caused the market to experience mispricing in assessing the persistence of operating cash flow components, non-discretionary accruals, and discretionary accruals components. It can be deduced that earnings expectations embedded in the stock returns more accurately reflected differences in the persistence of earnings component in line with the declining busyness level of independent directors. Therefore, hypothesis H3 was accepted for the independent director.

Table 6. Mispricing test results

Panel A. Market pricing of earnings components with respect to their implications for one-year-ahead earnings

| <i>Forecast Coefficients</i> | | | <i>Valuation Coefficients</i> | | |
|------------------------------------|-----------------|-------------------|--------------------------------------|-----------------|-------------------|
| Parameter | Estimate | Std. Error | Parameter | Estimate | Std. Error |
| γ_1 (CFO) | 0.861 | 0.038 | γ^*_1 (CFO) | 0.324 | 0.267 |
| γ_2 (NDAC) | 0.525 | 0.043 | γ^*_2 (NDAC) | 1.457 | 0.338 |
| γ_3 (DACC) | 0.502 | 0.055 | γ^*_3 (DACC) | 1.266 | 0.409 |
| γ_4 (CFO*BUSYCOM) | -0.006 | 0.015 | γ^*_4 (CFO*BUSYCOM) | 0.103 | 0.108 |
| γ_5 (NDAC*BUSYCOM) | 0.029 | 0.015 | γ^*_5 (NDAC*BUSYCOM) | -0.123 | 0.108 |
| γ_6 (DACC*BUSYCOM) | 0.012 | 0.019 | γ^*_6 (DACC*BUSYCOM) | -0.129 | 0.132 |
| γ_7 (CFO*BUSYDIR) | 0.048 | 0.016 | γ^*_7 (CFO*BUSYDIR) | 0.212 | 0.112 |
| γ_8 (NDAC*BUSYDIR) | -0.025 | 0.015 | γ^*_8 (NDAC*BUSYDIR) | 0.148 | 0.105 |
| γ_9 (DACC*BUSYDIR) | 0.027 | 0.021 | γ^*_9 (DACC*BUSYDIR) | 0.364 | 0.157 |
| γ_{10} (CFO*BUSYCOMMITTEE) | 0.043 | 0.018 | γ^*_{10} (CFO*BUSYCOMMITTEE) | -0.097 | 0.131 |
| γ_{11} (NDAC*BUSYCOMMITTEE) | -0.019 | 0.020 | γ^*_{11} (NDAC*BUSYCOMMITTEE) | -0.088 | 0.143 |
| γ_{12} (DACC*BUSYCOMMITTEE) | -0.017 | 0.027 | γ^*_{12} (DACC*BUSYCOMMITTEE) | -0.219 | 0.191 |

Panel B. Market efficiency tests

| <i>Null hypotheses</i> | Likelihood Ratio Statistic | Sig. |
|------------------------|-----------------------------------|-------------|
|------------------------|-----------------------------------|-------------|



| | | |
|----------------------------|----------|-------|
| $\gamma_1 = \gamma^*1$ | 0.324 | 0.285 |
| $\gamma_2 = \gamma^*2$ | ***7.487 | 0.003 |
| $\gamma_3 = \gamma^*3$ | **3.431 | 0.032 |
| $\gamma_4 = \gamma^*4$ | 0.979 | 0.161 |
| $\gamma_5 = \gamma^*5$ | 0.973 | 0.160 |
| $\gamma_6 = \gamma^*6$ | 1.125 | 0.144 |
| $\gamma_7 = \gamma^*7$ | *2.105 | 0.073 |
| $\gamma_8 = \gamma^*8$ | *2.634 | 0.052 |
| $\gamma_9 = \gamma^*9$ | **4.545 | 0.017 |
| $\gamma_{10} = \gamma^*10$ | 1.124 | 0.145 |
| $\gamma_{11} = \gamma^*11$ | 0.224 | 0.318 |
| $\gamma_{12} = \gamma^*12$ | 1.091 | 0.148 |

***Significant at 1 percent; ** Significant at 5 percent; * Significant at 10 percent.

Source: Processed research data, 2023

Sensitivity Analysis. To demonstrate the consistency of the research's results, we employed various measurements of the workload of the independent governance organs. This study used measurements from (Trinugroho et al., 2022) for sensitivity analysis. They set a certain threshold to say a board is busy. This study created a three-position threshold so that board members of independent corporate governance organs who held more than three positions outside the company were considered active. Board members with more than three posts received a dummy value of 1, while the rest received 0. The value of each variable was then calculated by averaging this dummy value. The sensitivity test findings for models (1) and (2) were consistent with the main test results. The results of the market mispricing test's sensitivity analysis are also compatible with the primary tests of market mispricing in **Table 6**.

DISCUSSION

The effect of the busyness level of independent corporate governance organs on earnings management. This study found that the busyness level of independent corporate governance organs that has a significant positive effect on earnings management is the busyness level of independent commissioners (BUSYCOM) and the busyness level of independent audit committees (BUSYCOMMITTEE). However, the busyness level of independent directors (BUSYDIR) does not affect earnings management. The positive impact of BUSYCOM and BUSYCOMMITTEE on the magnitude of earnings management indicates that the independent commissioner and independent audit committee, who should be a 'control system' for company management, is too busy with other positions, thereby reducing the intensity and quality of their monitoring. This finding is in line with research from (Ding and Wei, 2023), who concluded that intensive monitoring from an independent board is correlated with a significant reduction in discretionary accruals (management of earnings). The overly busy independent corporate governance organs receive asymmetric information from management and participate less in strategic decision-making (Chen et al., 2023). The Financial Services Authority in Indonesia should regulate the number of positions that can be held by independent corporate governance organs so that these organs can carry out optimal monitoring of companies, which in turn reduces aggressive earnings management activities.

This study also finds that the number of positions held by independent directors did not affect earnings management. There are numerous possible explanations for this finding, including (i) Indonesia adheres to a two-tier governance system in which the



independent director is assisted by an independent commissioner (Trinugroho et al., 2022) and an audit committee in carrying out the supervisory function (Priyana and Yanti, 2020). As a result, even while the independent board of directors is very busy, the company's supervision is nevertheless effective, and (ii) the busyness of independent directors only sometimes has a detrimental influence on the company. The number of positions held by independent directors outside of the company in relation to the independent director's degree of knowledge suggests that the independent director has exceptional expertise and that other companies want to hire him. With extensive work experience in other firms, the board's skills and quality are growing, allowing them to deliver more relevant advice and policies to the company based on their expertise in these other organizations (Tan et al., 2019). Independent directors' activities outside the company may strengthen their abilities and professionalism to remain competent in monitoring their operations despite their hectic schedules.

The effect of the busyness level of independent corporate governance organs on earnings persistence. For the second hypothesis, this study found that independent commissioners, independent directors, and independent audit committees had a negative effect on the persistence of the accrual components of earnings. The busyness level of independent commissioners is related to the poor quality of supervision and governance. The number of positions held by independent commissioners makes them unable to monitor effectively (Ferris and Liao, 2019) and attend crucial meetings (Wang et al., 2022). The role of the independent commissioner was also often associated with improving the quality of company earnings. (Islam et al., 2022) state that an independent board of directors will motivate management to concentrate on long-term financial performance and produce sound governance mechanisms. Effective corporate governance ultimately plays an essential role in supporting the integrity and sustainability of the company's business (Oktavia, 2020).

Conversely, weak company governance can lead to aggressive earnings management practices, which result in lower earnings quality (Asogwa et al., 2019; Boachie and Mensah, 2022). Furthermore, regardless of how talented the independent director is in carrying out his tasks, he is still an independent director with sufficient time who will prioritize overseeing business management and ensuring that the profit statistics of the companies he monitors are of high quality (Ferris and Liao, 2019; Trinugroho et al., 2022). The negative relationship between the busyness of independent directors and the persistence of the accrual component of earnings indicates that the busier the independent directors are, the poorer the quality of the earnings of the companies they monitor.

Furthermore, there are several explanations for why the audit committee's busyness reduces the persistence of the accrual components of earnings. The audit committee monitors the financial reporting process and limits opportunistic earnings management (Albersmann and Hohenfels, 2017). The audit committee is a subset of the board of commissioners under a two-tier governance scheme. Because of its position, the audit committee (especially an independent audit committee) has a greater responsibility than other members of the board to ensure that management does not use its position to engage in activities that are detrimental to shareholders and that the quality of the financial statements presented is maintained (Almarayeh et al., 2022). Therefore, the busier the independent audit committee, the worse the quality of their company monitoring, which in turn causes low earnings persistence. Thus, the Financial Services Authority needs to limit the number of positions in independent corporate governance organs to maintain the quality of corporate earnings through effective monitoring.



The effect of the busyness level of the independent corporate governance organs on market mispricing. This study's findings indicate that solely the independent directors' busyness level causes market mispricing. When the busyness level of independent directors was high, investors were unaware that companies had low earnings persistence, causing them to overvalue (overpricing) the components of earnings in companies with high levels of activity of independent directors. This condition reflected market mispricing of the earnings component. This finding also indicated that the capital market in Indonesia could have been more efficient in a semi-strong form. These findings imply the importance of limiting excessive busyness among independent directors because the busier independent directors are, the lower the quality of earnings reported by the company. As a result, investors will need clarification in evaluating the components of corporate earnings with highly busy independent directors.

CONCLUSION

There needed to be more research into the amount of activity of independent company governance organs. We got numerous results using panel data regression and the Mishkin test. First, while the busyness level of independent commissioners and independent audit committees had been empirically proven to have a positive effect on increasing the magnitude of earnings management and a negative impact on the persistence of the accrual component of earnings (both non-discretionary accrual components and discretionary accrual components), the busyness of these two organs did not cause a market to make an error in assessing the earnings component. Independent commissioners and audit committees who were too preoccupied with other roles outside the company could not focus on supervising the company, resulting in a decline in supervision quality. Therefore, it was unsurprising that their busy schedules could increase the magnitude of earnings management performed by the company and lower the quality of earnings in the businesses they supervise.

Moreover, there was a possibility that the independent commissioners' and audit committee's activity did not lead to an error in the market's evaluation of the company's earnings component. Investors may have used the independent commissioners' and audit committee's activity level as a guide to determine the persistence of the company's earnings component so that the market did not make an error in its evaluation of the earnings component. As a result, the market did not experience a mistake in assessing the persistence of the profit components even though the level of activity of the two organs was high.

Second, independent directors' workload is independent of earnings management's magnitude. Still, it needs to improve the stability of the accrual component of earnings and market uncertainty in analyzing earnings components. Independent directors with optimal time to oversee company management have good quality oversight of the company so that the profit figures of the companies they monitor have good quality (Ferris and Liao, 2019; Trinugroho et al., 2022). The busier the independent director, the lower the quality of the company's earnings. The busyness of independent directors might cause the market to make errors in estimating the components of earnings, in addition to lowering the quality of corporate profits. Thus, the independent director's function in supervising the company was crucial because when the independent director was busy, his activity might lead to low earnings persistence and erroneous market judgments.



This research has improved our knowledge of the effectiveness of company governance systems. This study examined the level of activity of independent corporate governance organs, which should have been researched more. The findings of this study can also be applied in the real world, where shareholders might assess the activities of the independent board candidates they intend to hire. Furthermore, this research did not support Financial Services Authority regulations that did not require the presence of independent directors for companies listed on the Indonesian Stock Exchange. The findings of this study demonstrated the significance of having an independent director to supervise the organization. The independent directors' busyness considerably impacted enhancing earnings management and diminishing earnings persistence, even leading to mistakes in market assessment. As a result, not requiring an independent director for a publicly traded corporation would be a poor choice.

There are numerous limitations to this study. Future research can look into topics that should have been included in this study. Future research can expand the research sample by comparing it to other countries. Furthermore, the scope of this study is limited to the level of engagement of the independent corporate governance institutions. Future research could consider how long a person has served as an independent company governance organ in a company because it is anticipated that the longer a person has served as an independent company governance organ, the less independence they have.

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