THE EFFECT OF EARNINGS PERSISTENCE AND EARNINGS TRANSPARENCY ON COMPANY PERFORMANCE WITH CORPORATE GOVERNANCE AS MODERATING VARIABLE

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ABSTRACT

Earnings persistence and earnings transparency are an important factors in company performance. The quality of financial statement will differentiate performance between one company to another. The research purposed to analyze the effect of earnings persistence and earnings transparency on the company performance. In addition, the research purposed to analyze corporate governance as a moderating variable can strengthens the effect between earnings persistence and earnings transparency on company performance. This research using sample of 363 firms-year in 2014-2016 and applying panel data analysis. The results show that earnings persistence variable has a positive significant effect on the company performance. Earning transparency also has a positive significant effect on company performance. For corporate governance as a moderation variable strengthens the effect between earnings persistence and earning transparency to the company performance. Size and age also have a positive significant effect on company performance.

Keywords: *earnings persistence; earnings transparency; company performance; corporate governance.*

1. INTRODUCTION

The company's performance information can be affected by factors such as earnings persistence (Francis et al., 2004) and earnings transparency (Daske et al., 2008). Management choose and change its accounting policies and corrections of errors to increase the reliability of the entity's financial statements and the comparability of financial statements of entities with financial statements of other entities (IAI, 2017).

The presence of signals of prosperity and welfare can be seen by the shareholders of the presentation of financial statements (in particular earnings) from the management. The earnings report is a relatively stable and sustainable profit. Penman and Zhang (2002) states that sustainable earnings are profits that have high quality and as an indicator of future earnings and here in after referred to as profit persistence (Sloan, 1996; Dechow dan Dichev, 2002; Francis et al., 2004).

Earnings are defined as the profit of the normal activity (net income before extraordinary items, NIBE). Conceptually, the profit persistence is profit that can be used as an indicator of future earnings. According to Beaver (2002), the discretionary accrual policy undertaken by management causes two consequences. First, if the policy brings the information of profit, then the policy will improve the quality of profit, so the profit more persistent. Second, if the policy does not bring uninformative earnings, then the policy will decrease the quality of profit, so the profit becomes blurred (opaque). Accrual policies that result in earnings persistence are the quality of accruals (Dechow and Dichev, 2002; Sloan, 1996). The financial statements of companies in a country with good corporate governance reflects the transparency of earnings may help investors to assess the implications of profit valuation and its changes (Herry et al., 2016; Francis et al., 2004; Barth et al., 2013).

The purpose of this study was to analyze (1) whether the earnings persistence has a significant positive effect on the company performance; (2) whether the earnings transparency has a significant positive effect on the company performance; (3) whether the corporate governance strengthens relation between earnings persistence and company performance; (4) whether corporate governance strengthens relation between earnings transparency and company performance. The difference of this study with previous research are (1) the addition corporate governance as moderating variable; (2) the addition of leverage as control variables on company performance.

Contribution of this study consisted of practical contribution and contribution to the development of science. Practical contribution of this research is to increase understanding about the company performance. Practical contribution for the regulator is to increase understanding about the company performance. A practical contribution to the Financial Accounting Standards Board (DSAK), the results of this study can be used as a reference for DSAK to provide technical standards in order to help companies improve the earnings transparency. A practical contribution to the profession of Management Accountants and the Institute of Management Accountants in Indonesia (IAMI) is expected to be helping the company to improve the quality and quantity of the annual report and financial statement. IAMI as a forum for management accounting profession that need to consider in making the technical guidelines for its members in making company reporting guidelines as policy. A practical contribution to the company and other interested parties are the results of this study can provide feedback and evaluation relating to criteria the financial statements. The research proves benefit of financial statements that appreciated by investors. Therefore, the company needs to improve the type and amount of information that disclosed in the annual report.

The contribution to the development of science are contributing idea, thought, additional information and additional empirical evidence of financial statements for further research. This study consists of five parts. The first part is the introduction. The second part is to discuss the related theory, previous research and development hypotheses. The third part is to discuss the ways of collecting samples and data. The fourth section discusses the results of research. The fifth section discusses the conclusions, recommendations and limitations of the study.

2. LITERATURE REVIEW

2.1. Earning Persistence and Company Performance

Penman (2003) differentiates earnings into two groups: sustainable earnings (earnings persistent or core earnings), and unusual earnings. Earnings persistence is expressed as high quality earnings, on the contrary if the unsustainable profit is expressed as a profit that has poor quality. Earnings persistence is a profit that has the ability as an indicator of future earnings generated by the company repetitive (long term and sustainable). While, unusual earnings or transitory earnings are temporarily generated earnings and cannot be repeatedly generated (non-repeating), so it cannot be used as an indicator of future period earnings.

The profit persistence is defined as the profit that can be used as the profit parameter itself. That is, current earnings can be used as an indicator of future earnings. An increasingly persistent profit shows more informative profits, conversely if profit is less persistent, then profit becomes less informative (Tucker and Zarowin, 2006).

Based on Dechow and Dichev (2002), profit persistence as one measure of earnings quality is measured from the earnings regression coefficient of current earnings in lagged earnings. In addition to earnings persistence, earnings quality can also be measured by accrual quality and smoothness (Francis et al., 2004). Accounting profit figures that lead to earnings persistence depend on three assumptions. First, the theory assumes that earnings provide information to shareholders about current profitability and future period expectations. Second, the theory assumes that current and future profitability inform shareholders about current and future dividends. Third, the theory assumes that the stock price equals the present value of the expected future dividend (Nichols and Wahlen, 2004).

H_1: Earnings persistence generates a positive effect on the company performance.

2.2. Earnings Transparency and Company Performance

Barth and Schipper (2008) define the earnings transparency in which the financial statements reveal the underlying economic entities in a manner that is easily understood by those using the financial statements. The financial statements do not reflect how well the earnings transparency can help investors assess the implications of profit valuation and its changes. This measurement is based on the relationship between stock prices, book value equity and earnings in net surplus valuations.

Herry et al. (2016) concluded that earnings transparency negatively affects the cost of equity. This means that companies that perform a profit transparency policy reflect changes in the company's economic conditions that can be understood and responded well by investors. Earnings transparency is a financial statement that reveals the underlying economic entity in a way that is easily understood by those using financial statements. The financial statements do not reflect how well the profit transparency can help investors assess the implications of profit valuation and its changes (Barth and Schipper, 2008). According to Herry et al. (2016), profit transparency negatively affects the cost of equity. This means that companies that perform a profit transparency policy reflect changes in the company's economic conditions that can be understood and responded well by investors.

Francis et al. (2004) concludes that there is a negative influence in the measurement of cost of equity and earnings transparency. Companies that develop earnings transparency will become associated with lower cost of equity because transparency reduces risks arising from asymmetric information and at the same time lowers the cost of capital. This is the result of a commitment to improve the quality of financial statements, which means the focus on companies in applying accounting standards (Leuz et al, 2003; Daske et al., 2008). Based on the explanation, the research hypothesis is proposed as follows:

H_2: Earnings transparency generates a positive effect on the company performance

2.3. Corporate Governance and Company Performance

Hezaky et al. (2014) examined the effect of earnings smoothing on firm performance listed on the Tehran Stock Exchange. The results showed that earnings smoothing did not affect company performance. Kustono (2011) examines whether the Eckel index is a reliable instrument for measuring earnings smoothing behavior and for identifying new instruments to measure earnings smoothing events. The findings are earnings smoothing aimed at motivating management behavior to influence future transactions and to increase company value.

H_3: Corporate Governance strengthens relation between earnings persistence and company performance

Earnings quality and good corporate governance is one of the important indicators in evaluating the company's value (Li, 2014). Dechow et al. (2010) research suggests that high earnings quality provides more information about company performance that is relevant to the specific decision made by the decision maker. In Demerjian's research, the existence of high profit quality under good corporate governance will reflect the company's current operating performance.

H_4: Corporate Governance strengthens relation between earnings transparency and company performance

3. RESEARCH METHOD

3.1. Research Design

This study aims to determine the factors that affect the company performance. These factors are earnings persistence and earnings transparency, so the research design is causality. The unit of analysis is the companies. The collection of data from manufacturing companies listed in Indonesia Stock Exchange. The time horizon of this study is cross-sectional and longitudinal with research period from 2014-2016.

3.2. Data and Sample

This study uses secondary data. Secondary data that used in this study are the financial statements of manufacturing companies listed in Indonesia Stock Exchange 2014-2016 period. Sample was taken using purposive sampling. Sampling criteria of this study were (1) manufacturing companies that listed in Indonesia Stock Exchange and be fully operational during the year, (2) the company never delisting from the Indonesia Stock Exchange, does not stop the activity, does not to halt operations at the stock market, does not merger and does not change the status of the industry over the years 2014-2016. (3) The financial statements are presented in the currency of rupiah, (4) present the financial statements are complete and have been audited from 2014 to 2016. Based on the criteria, reduction of samples are sixteen companies because the date of the Initial Public Offering (IPO) after January 2014, and nine companies due to negative equity value. Final sample of research is 363 samples (121 manufacturing companies for 3 years).

3.3. Variables and Measurement
Dependent Variable
Company Performance

The company's performance is proxied by stock return the formula for the total stock return is the appreciation in the price plus any dividends paid, divided by the original price of the stock (Hartono, 2013). The formula is as follows:

$$\mathbf{RET_{it} = (P_{it} - P_{it-1} + D_{it}) / P_{it-1}} \quad \text{……………(1)}$$

Independent variables

The first independent variable is the earning persistence (PERS). In this study, the concept and measurement of earnings persistence refers to Francis et al. (2004). Earnings persistence is measured from the current net income before extraordinary items (NIBE) capability over the next NIBE period. If NIBE is truly persistent, then the current NIBE can be used to predict future NIBE periods, so that NIBE demonstrates sustainable profit performance. If earnings performance is sustainable, in the sense of growing and stable, then dividend growth is also expected to increase and stable. Based on Beaver (2002), this study focuses on accrual management and more specifically accruals of discretion. Discretionary policy is the policy by which management is can flexibly control the accounting numbers. Healy (1985) states that the accrual of discretion is proxied by total accrual, assuming that non-discretionary accruals are relatively small rather than discretionary accruals.

The second independent variable is earning transparency (TRANS). The measurement of profit transparency is based on the relationship between stock prices, book value equity and earnings in net surplus valuation (Barth et al, 2013). The equations are as follows:

TRANS_A:

$$AR_{i,j,t} = \alpha^A_0 + \alpha^A_1 E_{i,j,t} / P_{i,j,t-1} + \alpha^A_2 \Delta E_{i,j,t} / P_{i,j,t-1} + \varepsilon_{i,j,t} \quad \text{……………(2)}$$

TRANS_B:

$$AR_{i,p,t} = \alpha^B_0 + \alpha^B_1 E_{i,p,t} / P_{i,p,t-1} + \alpha^B_2 \Delta E_{i,p,t} / P_{i,p,t-1} + \varepsilon_{i,p,t} \quad \text{……………(3)}$$

$$TRANS = TRANS\_A + TRANS\_B \quad \text{……………(4)}$$

TRANS_A calculation on model (2) to obtain R2 which is estimated by industry. The calculation of TRANS_B is found in model (3) to obtain R2 estimated by the portfolio. Transparency (TRANS) is the sum of R2 of TRANS_A and R2 of TRANS_B. The portfolio was obtained from the industrial regression residue and then divided into four portfolios for each year. Based on research Barth et al. (2013), the higher the regression of the rate of return on profit, the greater the profit transparency.

where:
j = industry
p = portfolio
AR = annual rate of return is measured from the beginning after the fiscal year of the company
E = earnings
ΔE = change in earnings
P = the price at the beginning of the year
ΔP = price changes

Moderating Variables

Corporate governance as moderating variable is calculated from the average value of shares held by external investors calculated by sum the total market value of shares outstanding until the end of the fiscal year minus the market value of shares held by internal and directors, divided by the number of shares held by all ordinary shareholders.

Control Variables
Control variables were as follow: (1) firms size was measured by natural logarithm of total assets (Wang, 2013), (2) age of the company since the establishment of the company. The indicator to measure the age of the company is since the company was established to operational activity (Alsaeed, 2005), (3) leverage, the debt ratio level illustrates the extent to which the owner's capital can cover the debt to outsiders and is a ratio that measures the extent to which the company is financed from debt (Suripto, 1999; Subiyantoro, 1997; Gunawan, 2000). Leverage ratio is a ratio to measure how good the company's capital structure. Capital structure is a permanent funding consisting of long-term debt, preferred stock and shareholder capital (Wahyono, 2002). This ratio is measured by long-term debts divided by total assets of the company.

4. RESULTS AND DISCUSSION

4.1. Descriptive Statistics and Correlations Matrix

table 1. descriptive statistics

Variables	Minimum	Maximum	Mean	Standar Deviation
CP	0.00125	59.54018	6.36634	11.40611
PERS	5.40428	19.63152	12.43632	2.16207
TRANS	0.32946	4.17780	2.34410	0.47206
SIZE	6.73006	18.31944	13.36043	1.78060
AGE	7.00000	102.0000	35.26630	17.55964
LEV	0.00000	0.64712	0.26129	0.29896

Note: CP: company performance; PERS: earnings persistence; TRANS: earnings transparency; SIZE: log total asset; AGE: company age; LEV: leverage.

Table 1 shows listed the results of descriptive statistics. Based on the results of descriptive statistical analysis, it can be seen that the average of company performance is good. This indicates that there is a little difference between the presented in the financial statements with the reality. Condition of the company's financial reports is good, although there are some companies experiencing financial difficulties. On average, companies earn higher profit even though there are some companies that suffered losses. Companies in this study by average using long-term debt to acquire assets and some companies are having trouble paying its debts.

Correlation matrix in Table 2 shows that earnings persistence and earnings transparency have a significant positive effect on the company performance according to predictions. Size and age have a significant positive correlation to the company performance in accordance predicted. Leverage has not significant correlation to the company performance.

table 2. pearson correlations matrix

VARIABLES	CP	PERS	TRANS	SIZE	AGE	LEV
CP	1					
PERS (p-value)	0.504 (0.045) *	1				
TRANS (p-value)	0.350 (0.053)	0.641 (0.064)	1			

	*	*				
SIZE (p-value)	0.572 (0.062) *	0.530 (0.713)	0.511 (0.445)	1		
AGE (p-value)	0.625 (0.005) ***	0.58 (0.157)	0.671 (0.002) ***	-0.644 (0.710)	1	
LEV (p-value)	0.634 (0.679)	0.445 (0.006) ***	-0.812 (0.001) ***	0.567 (0.213)	-0.564 (0.351)	1

*** Significant at the level of 1 percent; ** Significant at the level of 5 percent; *Significant at the level of 10 percent.

Classic assumption test of research model indicate that the model did not has multicollinearity, heteroscedasticity and autocorrelation problem. Based on research Gujarati and Porter (2009), t test and F can be used for multiple samples in this study.

table 3. regression results of the research model

$CP_{it} = \alpha + \beta_1 PERS_{it} + \beta_2 TRANS_{it} + \beta_3 CG_{it} + \beta_4 SIZE_{it} + \beta_5 AGE_{it} + \beta_6 LEV_{it} + \varepsilon_{it}$					
Variables	**Prediction**	**Coefficients**	**P-Value**	**Collinearity Statistic**	
				Tolerance	**VIF**
Constant	+/-	25.411	0.000***	--	--
CP	+	0.0326	0.818	0.510	1.960
PERS	+	0.0270	0.023**	0.962	1.040
TRANS	+	1.7631	0.015**	0.924	1.082
SIZE	+	10.678	0.000***	0.858	1.166
AGE	+	11.298	0.007***	0.797	1.254
LEV	-	0.8230	0.260	0.953	1.049
Total Observation			363		
Durbin-Watson Stat			2.027		
Kolmogorov-Smirnov Test			0.000		
Adjusted R^2			0.413		
Prob (F-Statistik)			0.000***		

**** Significant at the level of 1 percent; ** Significant at the level of 5 percent; *Significant at the level of 10 percent.*
Note: *CP: company performance; PERS: earnings persistence; TRANS: earnings transparency; SIZE: log total asset; AGE: company age; LEV: leverage.*

Table 3 shows the results of a test of hypothesis for the research model. Overall, all the independent variables of this study have an effect on the company performance. In this model, only leverage has not a significant effect on the company performance. Earnings persistence, earnings transparency, size, and age have a positive significant effect on the company performance.

4.2. Discussion of Research Results

The research results using multiple regression to support the hypothesis. This proves that the company needs the transparency and the integrity in the financial statements. Earnings persistence, earnings transparency, size, and age have a positive significant effect on the company performance. Age has not significant effect on the company performance, due to the increase in the company's sales and earnings. There are increased sales prices that improving economic conditions.

5. CONCLUSIONS

Based on test results, this study analyzes the positive effect of earnings persistence and earnings transparency on company performance. This study using 363 samples that obtained after the sample selection process to look the consistency of the research data company performance, which can be analyzed the effect of the consistency to the test variable in the study. Based on the results of research and the previous discussion, it can be concluded that the control variables, size and age have a significant positive effect on the company performance.

This study also showed that the higher the company's leverage, the more it tends to alter its financial statements. When the ratio of company's leverage is high, it means that the more difficulties the company will have to pay off its debts. This research only uses three variables control that affect the company

performance, consisting of the firm size, age, and leverage. Future research regarding this topic should attention that this study need to examined the factors that strengthen or weaken the research model as moderating variable besides corporate governance. Examples moderating variables to strengthen or weaken the effect in the research model such as information asymmetry variable, should be taken into consideration. Besides that, it would be better if future research involves all companies listed in Indonesia Stock Exchange, and also add the observation period. Control variables that affect the company performance may also be added, for example liquidity and sales growth.

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