

The effectiveness of POJK No.33/POJK.04/2014 In Improving the Competence and Integrity of Directors and Commissioners

Abstract

This study examines the effectiveness of the Financial Services Authority (OJK) Regulation No. 33 /POJK.04/2014 issued on December 8, 2014, concerning Directors and Commissioners. This study argues that the release of the new rules will enhance the predictive ability of abnormal accruals on profitability one year ahead. The sample was selected from mining sector companies from 2013 to 2017 and further divided into 2013-2014 and 2015-2017. The 2013-2014 period is designated as the pre-regulatory period with the assumption that the new regulations issued on December 8, 2014, did not affect the 2014 financial statements. The results show that the predictive ability of abnormal accruals in 2013-2014 and 2015-2017 are not significantly different. The insignificant finding may result from the inclusion of 2014 in the observation period. Additional testing by excluding 2014 shows that the predictive ability of abnormal accruals is higher after the enactment of the new rules. With regard to positive abnormal accruals, the predictive ability of positive abnormal accruals is higher after the new regulation was issued. The practical implication of this research is that the Financial Services Authority Regulation No. 33/POJK.04/2014 is effective in improving the competence and integrity of the Board of Directors and Commissioners.

Keywords: Signaling theory, Abnormal accruals, predictive ability, private information.

INTRODUCTION

On December 8, 2014, the Financial Services Authority (OJK) issued Regulation No. 33/POJK.04/2014 to replace the previous regulation of the Chairman of Bapepam-LK No: Kep-29/PM/2004 dated September 24, 2004, concerning the Board of Directors and Board of Commissioners of Public Companies. The new rules were expected to improve the morale and integrity of the Board of Directors and Commissioners because several new provisions had been added for individuals who wish to become Directors and Commissioners. These provisions include: 1) the Board of Directors and/or Board of Commissioners have never been found guilty of causing a company to be declared bankrupt. 2) the Board of Directors and/or the Board of Commissioners have never been convicted of a criminal act which is detrimental to state finances and/or the financial sector. 3) the Board of Directors and/or the Board of Commissioners have never failed to fulfill the obligation to submit annual reports and/or financial reports to OJK.

In addition to these three requirements, additional authority is also given to the Board of Commissioners to dismiss members of the Board of Directors. The authority given to the Board of Commissioners should drive Directors of public companies to maintain high moral integrity and to stay away from situations that might lead to the abuse of power. The Board of Commissioners is also encouraged to carry out its monitoring function more effectively to ensure the company's resources are efficiently allocated for the benefit of shareholders as well as for enhancing the credibility and transparency of financial reporting.

After POJK 33/POJK.04/2014 has been in effect for years, the question arises whether the POJK has succeeded in improving the integrity and competence of the Board of Directors and Board of Commissioners of public companies in Indonesia. To date, there have been no empirical studies testing the effectiveness of the new regulations. Therefore, this study attempts to provide evidence of the effectiveness of OJK rule No. 33/POJK.04/2014 by examining the predictive ability of earnings components following the release of the new rules. Prior research has found that accruals play an important role in determining earnings quality [20]. Accrual accounting recognizes unrealized gains or losses on a timely basis making earnings information more relevance to investors. In particular, accruals reduce the noise contained in earnings caused by the temporary cash flow component. However, the accrual component of earnings may contain transitory and non-recurring elements that reduce the ability of current earnings to predict future earnings [26].

One approach to assessing the predictability of earnings is to separate accruals into normal and abnormal accruals [19], [24]. However, managers can manipulate accruals to increase earnings for financial gain. According to a survey of 169 CFOs of public firms and interviews of 12 CFOs and 2 standard setters revealed that 20% of firms manage earnings to misrepresent economic performance [13]. This is commonly referred to as earnings management. In this perspective, earnings management is an opportunistic behavior driven by financial motives that may result in a decreased ability of the accrual component to predict future earnings. However, several prior studies have found that earnings management can be utilized to signal private information. Earnings management as a signaling device refers to the choice of accounting methods and other accrual policies that increase earnings informativeness [2], [6], [18]. In this perspective, managers use accruals to disclose private information about the company's prospects. Managers deliberately choose certain accounting and accrual policies that more reliably describe future growth

opportunities, making it easier for investors to predict future earnings and cash flows. The choice of accounting methods and policies are motivated to increase the relevance, reliability, and predictive usefulness of reported earnings. In contrast, opportunistic earnings management is driven by a desire to hide the true economic performance from investors which leads to irrelevant and unreliable earnings information.

This study argues that the application of the new rule improves the competence and integrity of the Directors and Commissioners. They will carry out their duties and responsibilities more effectively to increase company value and shareholder welfare. In addition, the financial reporting process becomes more transparent and fairly reflects the economic reality and firm performance. More specifically, this study argues that after the new OJK regulations were issued, accounting discretion is driven more by signaling purposes than by opportunistic motives. If this is true, the ability of abnormal accruals to predict future earnings is higher in the period where the new rules have been applied. This research contributes to the practice of corporate governance in Indonesia by providing insights into the competence and integrity of the Board of Directors and the Board of Commissioners after the enactment of the new regulation. In addition, the results of this study are useful for policymakers in setting more effective policies to encourage good corporate governance.

The new rules are predicted to have more influence on companies that are vulnerable to financial statement manipulation practices. Accordingly, a sample of companies was selected from the mining sector because of the higher tendency of financial statements manipulation. In December 2018, the Governor of Southeast Sulawesi was sentenced to 12 years in prison for bribery and gratification of mining permits in Buton and Bombana, Southeast Sulawesi [12]. Corruption in the mining sector has also received considerable attention from the KPK, stating annual state losses of IDR 15.9 trillion related to tax evasion [10]. In addition, a survey by the Indonesian Survey Institute in 2019 which was funded by the Australian Department of Foreign Affairs and Trade found that the mining sector is the most vulnerable sector to corruption and thus more likely to manipulate financial reports to hide true costs and profits [7].

LITERATURE REVIEW

Earnings management as a signaling tool refers to the choice of accounting methods and accruals policies to increase earnings informativeness [1], [6], [18]. From a signaling perspective, directors with high competence and integrity are expected to reliably convey the economic reality

of a company to shareholders. They are committed to minimizing information asymmetry between the company and investors by adopting the most appropriate accounting policies that better describe the company's prospects. Moreover, they put the interests of shareholders above all else. When it comes to the choice of accounting policies, they are expected to choose accounting and accruals policies that enhance the relevance of financial statements. They also refrain from manipulating accruals that are detrimental to shareholders and use accounting discretion to signal private information. Using accruals as a means of communicating private information will lead to a higher predictive ability of current earnings on future earnings. In contrast, earnings management which is driven by the desire to increase earnings as implied by agency theory can actually have a negative influence on the sustainability of the company [12]. Choosing a specific accrual policy driven by personal gains as implied by agency theory leads to lower predictability of earnings [2], [6].

From the perspective of signaling theory, management intervention in the financial reporting process to convey private information is something that can be justified and should even be supported. Managers have an information advantage over those who are outside the company because they are directly involved in day-to-day activities and help determine the direction of the company. They have access and skills to understand the company's conditions firsthand. These information advantages create information asymmetry between managers and investors. To reduce information asymmetry, managers willingly choose the most appropriate accrual and accounting policies that best describe the economic reality of the company [2]

The use of accruals as a signal device has long been identified by accounting scholars and has received empirical support. Some authors find evidence that managers use loan loss provisions to communicate private information about future operating performance [16]. Another author finds evidence that the market responds positively to abnormal accruals in the period before the stock split and at the time of the stock split announcement [18]. Stock split signals increase the credibility of accrual signals and in turn accrual signals strengthen stock split signals. In short, companies deliberately choose abnormal accruals to communicate personal information if they believe the company's future performance meets investors' expectations.

Despite no cash flow effect, the choice of accounting method might affect the company's financial results. For example, according to generally accepted accounting principles, companies are permitted to record lease transactions using the operating lease and capital lease methods based

on the economic substance of the underlying transactions. However, this flexibility is often used by lessees who are in financial difficulties to arrange lease transactions in such a way that they meet the requirements of the operating lease method. If it is not engineered, the most appropriate method to use is the capital lease method. Such intentional mistakes result in higher profitability ratios (ROI), higher asset turnover, and higher current ratios. As a consequence, the relevance of financial statements for investment decisions decreases [26]. On the other hand, companies with sound financial conditions and promising prospects will voluntarily adopt the capital lease method to send a positive signal to the market about the true profile of the company. If they choose the operating lease method, the market may have a wrong perception of the company's prospects, which causes the company's stock to fall. Thus, managers deliberately choose conservative accounting methods to give a signal to investors that the company's profits remain stable despite using conservative accounting methods. Furthermore, applying conservative accounting methods will result in a more persistent and stable income. Many analysts view conservative accounting policies produce higher-quality earnings than aggressive policies [26]. Conservative accounting policies reflect managers' beliefs about the company's future [25].

A manager can also utilize signal mechanisms to send signals about the success of research projects. Judging from his private information, the manager believes there will be a significant increase in sales in the coming year. This private information is very complex and cannot simply be disclosed to the public because it can be exploited by competitors. Alternatively, managers may decide to use discretionary accruals as a means of communicating the increased future sales to the market. One way is to revise the economic life of fixed assets to be longer or to reduce the allowance for doubtful accounts. Such revision will result in lower depreciation expense and in turn, will increase reported net income.

A signaling mechanism can also be used when the company wishes to give a signal about the increase in the collectability of the company's receivables. For example, from a personal meeting with a key customer, a manager learns that the market demand for a customer's product is expected to increase significantly in the next few years. Based on this fact, it is highly likely that the customer's financial condition will continue to improve in the future. This is a piece of private information that cannot be disclosed directly to the market. Alternatively, the company can reduce the allowance for doubtful accounts to provide a signal about the company's profit prospects in the future. The use of accruals for signaling purposes has received conceptual support from many

authors [2]. Managers deliberately choose certain accounting methods to express their expectations of future cash flows and the company's prospects.

Accruals Predictive Ability

Researchers have examined the predictive ability of accruals and cash flow components on future earnings and cash flow [4], [5], [17], [23]. One author examined the predictive ability of the accrual component and the cash flow component by correlating the two components with income one year ahead [19]. The results show that the accrual component is significantly correlated with income one year ahead. Other authors tested the predictive ability of abnormal accruals on future profitability and stock prices [15], [16]. Abnormal accruals are obtained by separating total accruals into non-discretionary and discretionary components using a cross-sectional Jones model. The results show that the ability of earnings to predict returns is better than cash flows and this is partly due to the accrual component contained in earnings. Additional testing shows that the discretionary accrual component contains more information content than the non-discretionary component. Subsequent research extends these studies by separating total accruals into normal and abnormal accruals and then relating them to next year's earnings [19]. They found abnormal accruals were positively correlated with future earnings, indicating the ability of abnormal accruals to provide signals about future profitability.

One study argues that the choice of accrual policy can be explained from three perspectives. They are the informational perspective, opportunistic meet-or-beat perspective, and efficient contract perspective [2]. The authors examine whether discretionary accruals policy choices affect the ability of accruals to predict future cash flows. The sample is selected from companies that restate the previous year's financial statements. They argue that by observing the restated financial statements, it is possible to directly measure the magnitude and direction of accrual accounts that are affected by managers. The results show that the predictive ability of the restated numbers on future cash flows for the opportunistic meet-or-beat companies is higher than the previously reported numbers. The findings indicate that accrual manipulation motivated by private motives reduces earnings informativeness. On the other hand, the results for firms that are not classified as meet-or-beat opportunistic, are consistent with the information perspective, suggesting the use of accruals as a signaling device can increase earnings informativeness.

POJK No.33/POJK.04/2014

In December 2014, the Financial Services Authority issued OJK Regulation

No.33/POJK.04/2014 to improve the integrity and competence of the Board of Directors and the Board of Commissioners. Several provisions were put in place to minimize the possibility of the Board of Directors and Board of Commissioners abusing their authority which could harm equity investors. The regulation explicitly states that the Board of Directors and the Board of Commissioners have never been involved in a legal case in the past and have high competence in the financial sector. In addition, they must be legally responsible for any negligence in carrying out their duties that are detrimental to the company and shareholders. These provisions are expected to suppress the opportunistic behavior of managers that harm the company. Thus, the people who are selected and qualified to serve in public companies are those who have high integrity and competence. They are expected to have a strong drive to put the interests of shareholders above their interests and to have the incentive to increase the transparency of financial reporting. Furthermore, they are expected to carry out their functions professionally to improve the welfare of the shareholders.

Managers are involved in the day-to-day activities of the company and have a deeper understanding of the company's conditions than outsiders. In light of OJK Regulation No.33/POJK.04/2014 to improve the integrity and competence of the Board of Directors and Commissioners, managers are expected to use appropriate accounting policies to convey inside information that best presents the future condition of the company and thus allows investors to fairly assess company prospects. As a component of earnings, accruals can be used as signals about future profitability, especially through the choice of discretionary component of accruals. By deliberately choosing a certain accrual policy, current earnings contain important information about future profitability. If discretionary (abnormal) accruals provide a signal about future profitability, it can be expected that abnormal accruals in current earnings have a significant correlation with future earnings. On the other hand, accrual policies that are deliberately chosen to meet certain targets reduce the ability of abnormal accruals to provide information on future profitability because they fail to reflect the economic reality of the company. Based on the preceding arguments, the relationship between abnormal accruals and future profitability is stated in the following hypothesis:

H1: The predictive ability of abnormal accruals is higher after the new regulation on Directors and Commissioners was issued in 2014.

Positive Abnormal Accruals

Conceptually, the intervention of financial reporting process through certain accrual policies may be directed to increase or decrease reported income. An increase in income occurs when managers deliberately choose certain accounting methods and accruals policies that have a positive effect on earnings. Specifically, positive abnormal accruals shall increase earnings while negative abnormal accruals decrease earnings. However, prior studies have shown that the use of accruals as a signaling device is more consistent with positive abnormal accruals than negative abnormal accruals [6]. Through private information signaling, managers reduce the information gap between management and shareholders and move the share price higher to the equilibrium value [18].

One study examines the correlation between executive stock transaction activity and abnormal accruals [6]. They argue that earnings quality may reflect executive stock trading activity because top executives have inside information about economic factors that can affect accrual persistence. The results show that companies whose executives make unusual stock purchases (abnormal) experience more persistent earnings than companies whose executives make abnormal stock sales. As for income-decreasing accruals, they did not find conclusive results. These findings suggest that income-increasing accruals are more frequently used as a means of signaling private information than income-decreasing accruals. Another study examined the market's reaction to abnormal accruals [22]. The authors argue and find that firms use accruals to signal privately held information when they believe that future performance will meet market expectations.

From a signaling standpoint, managers who effectively carry out their functions are expected to use accounting discretion responsibly through the choice of accruals that best describe the company's prospects. Since POJK No.33/POJK.04/2014 was issued to improve the integrity and competence of Directors and Commissioners, then following the release, earnings management as a signaling tool is predicted to be more dominant than opportunistic earnings management. Prior to the issuance of OJK Regulation No.33/POJK.04/2014, earnings management may have been both motivated for signaling or opportunistic purposes. However, after the enactment of POJK No.33/POJK.04/2014, flexibility in choosing accrual policies is expected to be more directed at helping investors assess future profitability rather than

opportunistic motives. Based on the preceding discussion, the relationship between positive abnormal accruals and future profitability is stated in the following hypothesis:

H2: The predictive ability of positive abnormal accruals is higher after the new regulation on Directors and Commissioners was issued in 2014.

RESEARCH METHOD

The sample was selected from the mining sector which is prone to corruption and manipulation of financial statements for the period of 2013-2017. In particular, the sample was selected according to the following criteria: 1) Companies were listed on the Indonesia Stock Exchange consecutively from 2013 to 2017. 2) Companies provide necessary data to measure the variables of interest.

Table 1. Sample Selection Procedure

| Criteria | Total |
|--|-------|
| Mining companies on the Jakarta Stock Exchange in 2017 | 45 |
| Companies are not consecutively listed on the IDX from 2013-2017 | (4) |
| Financial reports are not available from the data source | (6) |
| Final Sample | 35 |

The annual report is downloaded from the official website of the Indonesia Stock Exchange which publishes annual reports regularly. The final sample available for the test of hypotheses is 35 mining companies or 175 (35 x 5) observations as shown in Table 1.

Regression Models

Hypothesis one implies that after the issuance of POJK No.33/POJK.04/2014, the ability of abnormal accruals to predict future profitability increases. In other words, abnormal accruals as a proxy for earnings management are used as a signaling mechanism rather than achieving personal targets. The use of abnormal accruals to signal insider information is predicted to increase the informativeness of earnings because the accrual component contained in earnings reveals the prospects and economic realities of the company. If the signal theory predictions are correct, then abnormal accruals will be positively correlated with future earnings. Conversely, if the choice of

accounting policy is driven to meet certain targets, then the abnormal accrual component of income does not affect future earnings. As a result, the ability of abnormal accruals to predict future earnings decreases.

For statistical testing purposes, hypothesis one is restated as follows: the correlation of abnormal accruals with one-year-ahead profitability (net income to total assets ratio) is stronger in the 2015-2017 period than in 2013. The regression model to test hypothesis one is developed from equation (1) where current income can predict next year's income.

$$EARN_{t+1} = \gamma_0 + \gamma_1 EARN_t + \mu_t \quad (1)$$

Equation (1) is extended to equation (2) by decomposing earnings into cash and accrual components. Next, accruals are separated into normal accruals and abnormal accruals components, and some control variables are added.

$$EARN_{t+1} = \gamma_0 + \gamma_1 CFO_t + \gamma_2 NAC_t + \gamma_3 DER_t + \gamma_4 SIZE_t + \gamma_5 ABN_AKRU_t + \gamma_6 SKEP_t + \gamma_7 SKEPxABN_AKRU_t + \mu_t \quad (2)$$

Where: $EARN_{t+j}$ = Net income deflated by total assets (profitability ratio); CFO = Operating cash flow; NAC = Normal accruals estimated using a modified cross-sectional model of Jones (1991); ABN_AKRU = Abnormal accruals estimated from the cross-sectional modified Jones model; SKEP = dummy variable, 1 if the observation comes from the 2015-2017 period and 0 if the observation comes from 2013-2014; DER = Debt to Equity Ratio, SIZE = Firm size, log total asset at the beginning of the year; SKEPxABN_AKRU = Interaction variable.

Equation (2) is used to test the first hypothesis by inserting the dummy variable SKEP to distinguish the period before and after the new regulation was issued. SKEP is coded 1 for 2015-2017 and 0 for 2013-2014. The next step is to test the difference between the two regression coefficients before and after the new regulation using interaction variables, see [14] for more details. SKEPxABN_AKRU is an interaction variable that is used as the basis for determining statistical differences in the slope coefficient linking abnormal accruals and earnings one year ahead. Since the predictive ability of abnormal accruals for the 2015-2017 period is predicted to be higher than that of 2013-2014, hypothesis one is supported if the interaction coefficient is positive and statistically significant. Note again, SKEP is a dummy variable that takes 1 for 2015-2017 and 0 for 2013-2014. Thus, a positive interaction coefficient implies that the coefficient linking abnormal accruals and earnings one year ahead for the 2015-2017 period is higher than in 2013-2014, assuming the correlation between abnormal accruals and next year's profitability is

positive. It should be reminded that the determination of 2013-2014 as the period before the new regulations are issued is based on the assumption that the effects of the new regulations can only be identified in 2014 and beyond. Tests were also carried out by omitting the year 2014 from the sample period.

As discussed in the previous section, abnormal positive accruals can be used for opportunistic or signaling purposes. However, after the issuance of POJK No.33/POJK.04/2014, signaling purposes are expected to be more dominant than opportunistic purposes. If the signaling purposes are more dominant, then it can be expected that the predictive ability of abnormal accruals in the 2015-2017 period is stronger than in the 2013-2014 period. The predictive ability of positive abnormal accruals on profitability one year ahead is reflected in the slope coefficient that links positive abnormal accruals with profitability one year ahead. The regression model for testing hypothesis two is similar to hypothesis one but includes only positive abnormal accruals. The following is a regression model to test hypothesis two:

$$\text{EARN}_{t+1} = \gamma_0 + \gamma_1 \text{CFO}_t + \gamma_2 \text{NAC}_t + \gamma_3 \text{DER}_t + \gamma_4 \text{SIZE}_t + \gamma_5 \text{ABN_POS}_t + \gamma_6 \text{SKEP}_t + \gamma_7 \text{SKEP} \times \text{ABN_POS}_t + \mu_t \quad (3)$$

Where: EARN_{t+1} = Net income deflated by total assets (profitability ratio); CFO = Operating cash flow; NAC = Normal accruals using the modified Jones model; ABN_POS = Positive abnormal accruals estimated from the modified Jones model; SKEP = dummy variable, 1 if the observation comes from the 2015-2017 period and 0 if the observation comes from 2013; DER = Debt to Equity Ratio, SIZE = Firm size, log total asset at the beginning of the year; SKEP \times ABN_POS = Interaction variable.

SKEP \times ABN_POS is the interaction variable that indicates statistical differences in the slope coefficient relating positive abnormal accruals with one-year ahead earnings in the 2013-2014 and 2015-2017 periods. If the interaction coefficient is positive and statistically significant, then hypothesis two is supported. This means that the slope coefficient associated with 2015-2017 was higher than the slope coefficient in 2013-2014. If the interaction coefficient was not statistically significant, then the predictive ability of positive abnormal accruals did not differ in the two periods.

Abnormal Accruals

The following modified Jones model is used to measure abnormal accruals.

$$\text{ACCR}_t / \text{TA}_{t-1} = (1 / \text{TA}_{t-1}) + \gamma_1 (\Delta \text{REV}_t - \Delta \text{RECT}_t / \text{TA}_{t-1}) + \gamma_2 (\text{PPE}_t / \text{TA}_{t-1}) + e_t \quad (4)$$

Note that $ACCR_t$ is the company's total accruals in year t , TA_{t-1} is the company's total assets in year $t-1$, ΔREV_t is the change in the company's net income in year t , ΔREC_t is the change in receivables in year t and PPE $_t$ is property, plant, and equipment in year t . Total accruals are the difference between net income and operating cash flows. The model is estimated cross-sectionally for each year. Abnormal accruals are the residuals obtained from the estimation of the modified Jones model.

Control Variables

Leverage and firm size were added to the model to reduce the effect of firm characteristics on profitability. Previous studies have shown that leverage is negatively related to profitability [1], [9], [21], and firm size is positively related to profitability [1].

RESULTS AND DISCUSSION

As previously explained, this study examines the predictive ability of accrual abnormal following the issuance of POJK No.33/POJK.04/2014. The sample period is 2013-2017. Since the new regulation was released in December 2014, it is difficult to determine exactly when it will impact mining sector companies. For this reason, this study conducted a test using two different sample periods where 2014 was omitted in the second test. Thus, this study compares the predictive ability of abnormal accruals in 2013-2014 and 2015-2017 followed by a second test that compares the predictive ability of abnormal accruals in 2013 and 2015-2017. A total of 75 observations met the sample criteria. However, five measurements that fall outside the three standard deviations of the mean are omitted to reduce the effect of extreme values on the validity of the inferences. Table 2 presents the minimum, maximum, mean, and standard deviation values for all variables.

$EARN_{t+1}$ has a mean of 0.041 and a standard deviation of 0.143. Note that this variable has been deflated by total assets to reflect profitability. Thus, the mean value indicates that the sample-firm profitability is 4.1%. A fairly large standard deviation indicates that the profitability of the sample companies varies. Normal accruals (NAC) have a mean of -0.019, suggesting that the proportion of normal accruals is 1.9% of total assets. The negative value indicates the decreasing effect of normal accruals on earnings. The mean for abnormal accruals (ABN_AKRU) is -0.014, suggesting that abnormal accruals of firm samples reduce earnings by 1.4% of total assets.

Table 2. Descriptive Statistics

| Variables | N | Minimum | Maximum | Mean | Std. Dev. |
|---------------------|-----|---------|---------|--------|-----------|
| EARN _{t+1} | 170 | -0.777 | 0.605 | 0.041 | 0.143 |
| NAC | 170 | -0.507 | 0.278 | -0.019 | 0.086 |
| ABN_AKRU | 170 | -0.478 | 0.824 | -0.014 | 0.162 |
| SKEP | 170 | 0 | 1 | 0.600 | 0.490 |
| CFO | 170 | -1.870 | 7.225 | 0.876 | 0.896 |
| SIZE | 170 | 25.221 | 32.156 | 29.122 | 1.486 |
| DER | 170 | -0.641 | 0.670 | 0.067 | 1.294 |

The mean for SKEP is 0.60, indicating that 60% of the sample comes from the 2015-2017 period. An additional test shows that earnings predictive ability is lower prior to the release of POJK, 0,160 and 0,424 respectively. The mean operating cash flow (CFO) of 0.876 indicates that the cash flow component in current income is 87.6% of total assets. The mean for SIZE and DER is 29.122 and 0.067 respectively, suggesting that the sample companies are medium-sized companies with a moderate level of debt.

Correlation Coefficient

The correlation between the dependent variable and the independent variable is presented to see the pattern of the relationship between variables. Table 3 reports the Spearman correlation coefficient for all variables except for the dummy variable SKEP. EARN_{t+1} has a significant positive correlation of 0.287 with ABN_AKRU at the 1% level. This suggests that the higher the abnormal accrual, the higher the profitability one year ahead. On the other hand, EARN_{t+1} has a negative correlation of -0.218 with normal accruals (NAC) at the 1% level. This means that the higher the normal accrual, the lower the profitability one year ahead. Meanwhile, cash flow (CFO) has no significant relationship with profitability one year ahead. Overall, the correlation coefficient of the three components of earnings shows that the accrual component has a higher information content than the cash component. Of the two control variables, only debt maturity (DER) is significantly correlated with future profitability.

Table 3. Correlation Coefficients

| | EARN t+1 | NAC | ABN_AKRU | CFO | SIZE | DER |
|----------|----------|----------|----------|--------|--------|----------|
| EARN t+1 | 1 | -0.218** | 0.287** | -0.113 | 0.143 | 0.430** |
| NAC | -0.218** | 1 | -0.611** | 0.012 | -0.044 | -0.325** |
| ABN_AKRU | 0.287** | -0.611** | 1 | -0.029 | 0.049 | 0.074 |
| CFO | -0.113 | 0.012 | -0.029 | 1 | -0.021 | -0.113 |
| SIZE | 0.143 | -0.044 | 0.049 | -0.021 | 1 | 0.072 |
| DER | 0.430** | -0.325** | 0.074 | -0.113 | 0.072 | 1 |

*Significant at 5% level, **Significant at 1% level

Test of Hypothesis One

Table 6 presents the estimation of equation (2) where $SKEP \cdot ABN_AKRU$ is used as the basis for testing hypothesis one. Hypothesis one predicts that the correlation between abnormal accruals and profitability one year ahead is stronger after the new regulation was enacted. Specifically, the $SKEP \cdot ABN_AKRU$ coefficient reflects the difference in the slope coefficient between the 2015-2017 and 2013-2014 periods. The positive coefficient indicates that the correlation between abnormal accruals and profitability one year ahead in 2015-2017 is higher than in 2013-2014. Before discussing the findings, a preliminary test was conducted to assess the correlation between abnormal accruals and profitability one year ahead. This test is necessary to determine the sign of the regression coefficient that connects ABN_AKRU and profitability one year ahead. Table 4 and Table 5 present the estimation results. It should be noted that $SKEP$ and $SKEP \cdot ABN_AKRU$ are not included in the estimation model because this test is not intended to compare the differences in the regression coefficients in two different periods.

Table 4 presents the predictive ability of abnormal accruals (ABN_AKRU) on profitability one year ahead in the 2013-2014 period. The slope coefficient is positive as expected but not statistically significant. Similarly, cash flows from operations (CFO) and normal accruals (NAC) are not significantly related to the next year's profitability. The F statistics and adjusted R^2 are 1.523 and 0.038 respectively. Overall, these findings suggest that before the enactment of the new rules, the current earnings component was irrelevant for predicting future profitability.

Table 4. Accrual Abnormal Predictive Ability In 2013-2014

| Variables | Expected Sign | Coeff | t stat | P value |
|-----------|---------------|--------|--------|---------|
| CFO | + | -0.005 | -0.174 | 0.863 |

| | | | | |
|----------------------------|-----|--------|--------|-------|
| NAC | +/- | -0.460 | -0.514 | 0.609 |
| ABN_AKRU | + | 0.169 | 1.433 | 0.157 |
| SIZE | + | 0.017 | 1.355 | 0.180 |
| DER | - | 0.191 | 1.344 | 0.184 |
| F = 1.523 | | | | |
| Adj. R ² =0.038 | | | | |

Different results were identified for 2015-2017 as reported in Table 5. ABN_AKRU and NAC are significantly correlated with EARN_{t+1} at the 1% level. The F statistics and adjusted R² are 15.277 and 0.414 respectively. These statistics are greater than those of the 2013-2014 period, suggesting higher information content of earnings components to predict future profitability after the release of new rules. The next step is to test whether the regression coefficient with the 2015-2017 observation years is statistically higher than that of 2013-2014. Table 6 reports the results. The correlation of abnormal accruals to one-year profitability is significant at the 5% level. In contrast, normal accruals (NAC) and operating cash flows (CFO) are not significantly correlated

Table 5. Accrual Abnormal Predictive Ability In 2015-2017

| Variables | Expected Sign | Coeff | T stat | P value |
|----------------------------|----------------------|--------------|---------------|----------------|
| CFO | + | -0.014 | -1.253 | 0.213 |
| NAC | +/- | -0.395 | 2.472 | 0.015 |
| ABN_AKRU | + | 0.409 | 4.248 | 0.000 |
| SIZE | + | 0.001 | 0.167 | 0.868 |
| DER | - | 0.614 | 6.487 | 0.000 |
| F = 15.277 | | | | |
| Adj. R ² =0.414 | | | | |

with future profitability. Overall, the findings suggest that the information content of abnormal accruals associated with future profitability is higher than that of NAC and CFO.

Table 6. Accrual Abnormal Predictive Ability In 2013-2014 Vs 2015-2017

| Variables | Expected Sign | Coeff | T stat | P value |
|------------------|----------------------|--------------|---------------|----------------|
| CFO | + | -0,012 | -1,093 | 0,276 |
| NAC | +/- | 0,269 | 1,559 | 0,121 |

| | | | | |
|----------------------------|-----|-------|-------|-------|
| ABN_AKRU | + | 0,203 | 1,981 | 0,049 |
| SKEP | +/- | 0,047 | 2,356 | 0,020 |
| SKEP*ABN_AKRU | + | 0,172 | 1,175 | 0,242 |
| SIZE | + | 0,006 | 0,928 | 0,355 |
| DER | - | 0,448 | 5,649 | 0,000 |
| F = 10,061 | | | | |
| Adj. R ² =0,272 | | | | |

The main focus is on SKEP*ABN_AKRU. Table 6 shows that the interaction variable is not significantly correlated with profitability one year ahead with a p-value of 0.242. The finding suggests that the predictive ability of abnormal accruals before and after the new rules is not statistically different, indicating that the new regulation issued by OJK is not effective in improving the competence and integrity of the Board of Directors and Commissioners. However, generalizations shall be made carefully. An additional test concerning the years where the effect of the new rules was initially observed should be carried out to mitigate errors in variables.

The insignificant difference in the predictive ability of abnormal accruals between the two periods may be due to the incorrect determination of the sample period, as was previously mentioned. Considering the issuance date in December 2014, the effects of the new rules may have already occurred in 2014. Therefore, an additional test was carried out by omitting 2014 from the observation period. Specifically, the predictive ability of abnormal accruals in 2013 is compared with 2015-2017. Before getting into the results, the predictive ability of abnormal accruals in 2013 is first presented in Table 7.

Table 7 shows that abnormal accruals and profitability one year ahead are not significantly associated with a p-value of 0,637. Similarly, CFO and NAC are not significantly associated with profitability as well, suggesting that before the enactment of POJK No.33/POJK.04/2014 earnings components have no information content on future profitability. These findings are contrary to the test using the 2015-2017 period as reported in table 5.

Table 7. Accrual Abnormal Predictive Ability In 2013

| Variables | Expected Sign | Coeff | T stat | P value |
|------------------|----------------------|--------------|---------------|----------------|
| CFO | + | -0,008 | -0,390 | 0,699 |
| NAC | +/- | 0,011 | 0,015 | 0,988 |

| | | | | |
|----------------------------|---|--------|--------|-------|
| ABN_AKRU | + | -0,032 | -0,477 | 0,637 |
| SIZE | + | 0,003 | 0,309 | 0,309 |
| DER | - | 0,142 | 1,498 | 1,498 |
| F = 0.823 | | | | |
| Adj. R ² =0.029 | | | | |

A test of differences in the predictive ability of abnormal accruals in 2013 and 2015-2017 is presented in Table 8. SKEP*ABN_AKRU coefficient is significantly associated with future profitability at 1% (p-value of 0.003). A positive sign suggests that the predictive ability of accrual abnormal in 2015-2017 is higher than that of 2013. Two inferences can be drawn: 1) The effects of new rules have already occurred in the 2014 financial statements. 2) The new rules effectively improve the integrity and competence of the Board of Directors and the Board of Commissioners.

Table 8. Accrual Abnormal Predictive Ability In 2013 Vs 2015-2017

| Variables | Expected Sign | Coeff | T stat | P value |
|----------------------------|----------------------|--------------|---------------|----------------|
| CFO | + | -0,015 | -1,620 | 0,108 |
| NAC | +/- | 0,326 | 2,205 | 0,029 |
| ABN_AKRU | + | 0,016 | 0,163 | 0,871 |
| SKEP | +/- | 0,037 | 1,730 | 0,086 |
| SKEP*ABN_AKRU | + | 0,391 | 2,989 | 0,003 |
| SIZE | + | 0,000 | -0,078 | 0,938 |
| DER | - | 0,461 | 6,302 | 0,000 |
| F = 10,061 | | | | |
| Adj. R ² =0,272 | | | | |

Test of Hypothesis Two

Note again that positive abnormal accruals will increase reported earnings. From an opportunistic point of view, managers are motivated to manipulate earnings through positive abnormal accruals to get bonuses or other compensation that was tied to reported earnings. From a signaling perspective, however, managers are expected to use positive abnormal accruals to convey private information, enabling investors to credibly estimate future earnings. Thus, if POJK No.33/POJK.04/2014 succeeded in achieving its targets, then the predictive ability of positive abnormal accruals on future profitability will be higher after the release of POJK No.33/POJK.

04/2014. The interaction variable SKEP*POS is inserted to test coefficient differences in 2013-2014 and 2015-2017 and the result is reported in Table 9. The coefficient of SKEP*POS is positive and significant at the 1% level of significance, suggesting a higher predictive ability of positive abnormal accruals in the period of 2015-2017 relative to 2013-2014. The findings support hypothesis two that POJK No.33/POJK.04/2014 improves the competence and integrity of Directors and Commissioners. In addition, operating cash flow (CFO) and normal accruals (NAC) are positively associated with future profitability at 10% and 1% respectively. These findings are consistent with [6], [16], [18] which also used the signaling theory framework.

**Table 9. Positive Abnormal Accruals Predictive Ability
In 2013-2014 Vs 2015-2017**

| Variables | Expected Sign | Coeff | T stat | P value |
|----------------------------|----------------------|--------------|---------------|----------------|
| CFO | + | -0,021 | -1,763 | 0,082 |
| NAC | +/- | 0,838 | 3,244 | 0,002 |
| ABN_POS | + | 0,054 | 0,502 | 0,617 |
| SKEP | +/- | 0,025 | 0,909 | 0,367 |
| SKEP*POS | + | 0,551 | 2,655 | 0,010 |
| SIZE | + | -0,009 | -1,120 | 0,266 |
| DER | - | 0,806 | 7,202 | 0,000 |
| F = 16,817 | | | | |
| Adj. R ² =0,590 | | | | |

Additional testing was also carried out by excluding 2014 from the observation period to allow comparison to the findings reported in Table 8. Table 10 presents the differences in abnormal accrual predictive Ability between 2013 and 2015-2017. The coefficient of SKEP*POS is positive and significant at less than 1% which is qualitatively similar to the findings reported in Table 8. Thus, it can be concluded that after the regulation was issued, the integrity and competence of the Directors and the Commissioners increased, and the choice of accounting policy is more directed at communicating personal information through a positive abnormal accrual signaling mechanism rather than efforts to meet personal targets.

**Table 10. Positive Accrual Abnormal Predictive Ability
In 2013 Vs 2015-2017**

| Variables | Expected Sign | Coeff | T stat | P value |
|----------------------------|----------------------|--------------|---------------|----------------|
| CFO | + | -0,021 | -1,865 | 0,067 |
| NAC | +/- | 1,175 | 4,264 | 0,000 |
| ABN_POS | + | 0,115 | 1,065 | 0,292 |
| SKEP | +/- | 0,057 | 1,826 | 0,073 |
| SKEP*POS | + | 0,577 | 2,930 | 0,005 |
| SIZE | + | -0,007 | -0,922 | 0,361 |
| DER | - | 1,069 | 7,594 | 0,000 |
| F = 16,817 | | | | |
| Adj. R ² =0,590 | | | | |

CONCLUSION

In December 2014 the Financial Services Authority issued a new regulation regarding the Board of Directors and Board of Commissioners of Issuers or Public Companies as stipulated in Financial Services Authority Regulation NUMBER 33/POJK.04/2014. The new regulation replaces Kep-29/PM/2004 dated 24 September 2004 issued by the Chairman of Bapepam-LK concerning the Board of Directors and Board of Commissioners of a Public Company. To date, no empirical studies have ever conducted to test the effectiveness of the new regulation. This study attempts to fill the gap by testing the predictive ability of abnormal accruals to predict profitability one year ahead after the regulation was issued.

In particular, this research is based on the premise that additional regulations aimed at improving the integrity of the Board of Directors and the monitoring function of the Board of Commissioners should encourage corporate managers to be more accountable to the stakeholders. Thus, opportunistic behavior is expected to decline and managers will be more transparent to present financial statements, leading to the increased quality of financial reporting. Moreover, accounting discretion is more directed to allow users of financial statements to understand the economic reality of the company, and increase the predictability of current earnings. Managers are expected to choose the accrual policy that best describes the company's prospects. Private information that cannot be disclosed openly in the financial statements is communicated to investors through the selection of the accrual policies that best describe the company's prospects.

If these assumptions work as expected, the predictive ability of current earnings will improve. Specifically, abnormal accruals (discretionary accruals) are utilized for signaling purposes rather than opportunistic purposes.

The focus of this research is to compare the correlation of abnormal accruals with profitability one year ahead before and after the new rules were implemented. Two hypotheses are proposed: 1) The correlation of abnormal accruals with the profitability one year ahead is stronger after the enactment of the new rules. 2) The positive correlation of abnormal accruals with profitability one year ahead is stronger after the enactment of the new rules. The firm samples were selected from the mining sector for the period 2013-2017 and divided into two groups of samples. The first group consists of firm years selected in 2013-2014 which represent the period before the enactment of the new OJK regulations and the second group is firm years which represent the post-enactment period. It should be noted that the designation of 2013-2014 as the period before the enactment of new rules is based on the assumption that the new rules will only have an impact on the 2015 financial statements and beyond.

The test of hypotheses shows the following results: 1) The predictive ability of abnormal accruals during the period 2013-2014 and 2015-2017 was not significantly different. However, the insignificant result may have been caused by the choice of observation period when determining the two sample groups to be compared. 2) Further testing by eliminating the 2014 observation year shows that the predictive ability of abnormal accruals was higher after the enactment. 3) The predictive ability of positive abnormal accruals was higher from 2015-2017 relative to the 2013-2014 period. The result of the additional test by excluding 2014 from the sample period remains consistent. Overall, the results of hypothesis testing indicate that the Financial Services Authority Regulation NUMBER 33/POJK.04/2014 has successfully achieved its target.

Given the inconsistent findings between tests with or without 2014, further research needs to extend the sample period. It should be noted that the old regulation concerning functions and authorities of the Board of Directors and the Board of Commissioners was stipulated in the Decree of the Chairman of Bapepam-LK Number: Kep-29/PM/2004 dated September 24, 2004. Therefore, further research is recommended to extend the sample period starting in 2004 to obtain more comprehensive and conclusive results. In addition, the inconsistent findings may be due to the application of different methods in estimating abnormal accruals. Future studies are suggested

to use alternative methods as suggested in [8] and then compare the results from these different methods to see the consistency of the findings.

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