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IMPACT OF CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT – EXPERIMENTAL EVIDENCE ON LISTED COMMERCIAL BANKS IN VIETNAM

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Abstract

Earnings management is the practice of adjusting accounting policies to change earnings. It affects the earnings of the banking industry, including listed commercial banks. It also reduces the trust of investors because the information provided is unreasonable for the bank system. Corporate governance as a management organization can prevent earnings management in the banking industry. The paper aims to consider the impact of corporate governance on the earnings management of listed commercial banks in Vietnam. The paper uses a time series of ten years from 2012 to 2021. The research uses experiments to test the hypothesis of the model. The result finds three factors positively affect the earnings management of listed commercial banks, including the number of members, professional qualifications, and meetings of the board of directors. The number of members is the strongest influence on earnings management, while the professional qualifications have the lowest effect. The results also demonstrate that listed commercial banks have practiced earnings management in recent years. From there, the paper proposes some policies to prevent the earnings management of listed commercial banks to improve the quality of information.

Keywords director, duality, female, meetings, manager, profit

JEL Classification D81, G34, M41, M42

INTRODUCTION

Earnings management has affected the interests of stakeholders, including the board of directors (abbreviated as Board) and directors. The Board detects earnings management fraud and has the necessary recommendations to limit these practices. Metawee (2013) considers the director as the direct operation manager, which can lead to earning information asymmetry for the Board. Earnings management creates unequal benefits between the Board and the individual acts of the directors (Ronen & Yaari, 2008). The oversight of the Board can limit the opportunities of directors to implement earnings management (Moradi et al., 2012). Through directors' compensation and benefits from the Board, directors can do accounting policies to adjust earnings. Earnings management causes a loss of confidence among investors and stakeholders, which has negatively impacted the image and reputation of the business (Nugroho & Eko, 2012). When tasked to directly operating the business, the directors tend to influence the accounting policies to ensure the earnings on the financial statements satisfy the objectives (Gulzar & Wang, 2011). It is considered earnings management and mainly derived from the directors' personal goals (Metawee, 2013). The act of manipulating earnings so that information is affected makes investors misunderstand the company's performance (Healy & Wahlen, 1999). The Board does the supervision review of all issues related to the quality of the information in the financial statements. The characteristics of the Board are important to control earnings management through the control of earnings in the review of the figures on the financial statements (Azeez et al., 2019). The discussion and supervision from the Board are the basis for appropriate solutions to limit profit management (Kankanamage, 2015).

In Vietnam, the Law on Securities (2019) and the Law on Enterprises (2020) have regulations related to acts of falsifying accounting information. However, the current earnings management status of Vietnamese banks still has certain shortcomings (Tran et al., 2020). The Board of Vietnamese banks is concerned but not enough to prevent these behaviors. These are challenges that hinder the quality of stakeholder information (Thinh et al., 2022). It is a matter of concern because it affects the quality of information in the banking system in the context of global integration.

1. LITERATURE REVIEW AND HYPOTHESES

Healy and Wahlen (1999) consider Board regulates the corporate performance of managers. Board is about adding value for a company to form an effective governance system so Board must find ways to react to the inconsistency of interest between minority shareholders and the directors (Bala & Kumai, 2015). According to the Organization for Economic Cooperation and Development (2021), Board policies play a significant role in achieving economic goals related to investor confidence, capital accumulation, and allocation. Board is a system of an enterprise's legal elements, institutions, and management practices. It allows for attracting financial and human resources to create long-term economic value for shareholders (Daghsni et al., 2016). The Board is the representative to make decisions about the main business of the enterprises and they have the authority to deal with the issues issued by the directors (Gulzar & Wang, 2011). The success of the company is determined by the Board, so the role of the Board can be considered the highest in the management hierarchy of the Board mechanism. Therefore, if Board works effectively, it increases the quality of financial statements and limits earnings management (Rahman & Ali, 2006).

Earnings management is evident when managers make subjective decisions through the selection of different accounting policies for personal gain (Hooghiemstra et al., 2019). Earnings management is implemented when the directors have cut the data and adjusted it according to the individual's subjectivity, and that is the dark area in which accounting has been influenced to falsify (Levitt, 1998). Healy and Wahlen (1999) argue that when the directors use personal opinions as information on financial statements to change or affect economic transactions. It arises to make the information users misunderstand the status of the company, and the earnings management appears. Furthermore, earnings management is the use of accounting policy to influence accounting profit and operating cash flow, and the action by managers is intended to cover up company weaknesses on financial statements and cover up the truth of the results of operations (Ronen & Yaari, 2008)). Earnings management is considered to use subjective judgments to manipulate profit information to beautify the financial statements of the business (Hsu & Wen, 2015).

Agency theory holds that the principal and the principal form an agency relationship and that both parties in the relationship (Board & directors) want to maximize their benefits. The separation between the Board and the directors forms an agency relationship, where the principal is the Board and the principal is the director. However, the relationship leads to disagreement because calculations and arrangements can be between the parties to ensure their interests above all. Agency theory can originate from the separation and conflict of interest between the Board and the directors. The Board is the person who has the authority to make executive decisions with a supervisory mechanism that requires the directors to be accountable through the provision of financial and accounting information shown in the financial statements under the supervision of the Board (Jensen & Meckling, 1976). Agency theory is intended to interpret the role of the Board to control earnings management. It is the basis to strengthen

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the control of the Board to reduce earnings management. It helps enhance the quality of financial statements information and ensures fairness and trust for information users.

Stakeholder theory has created a different view of the relationship between stakeholders. Stakeholder theory holds that not being able to best address the interests of stakeholders for the benefit of one group can lead to the detriment of the other. As such, the important job of the Board is to find ways to balance the interests of the groups. The Board, as the representative of shareholders, needs to find a way to ensure the balance and fairness of the interests of the stakeholders (Freeman, 1984). Similar to the above, the use of stakeholder theory is intended to explain the role of the Board to control stakeholder interests. It is the basis to strengthen the control of the Board to ensure that the interests are harmonized between the parties. It also means that the benefits are not concentrated by one party and it reduces earnings management. It creates fairness for stakeholders and it helps transparent information on financial statements.

Many studies are looking at earnings management because of the many factors that influence it. Studies reviewed by enterprises are more popular than in the banking sector because of their representativeness (Bala & Kumai, 2015; Kankanamage, 2015; Hamid & Bello, 2019; Tran et al., 2020). For the banking sector, the popularity of earnings management is considered as the influence of the Board. Typically, Cornett et al. (2008) consider a sample of 46 banks in the period 1994–2002. The paper does quantitative to check hypotheses. The research elicits independent members to influence earnings management. Shen (2016) uses a sample of 16 joint stock banks listed in China between 2005 and 2014. The paper also performs quantitative to check the research. The research affirms that the number of members of the Board and duality affect earnings management. Oladipupo (2018) explored Nigerian listed commercial banks in the 10-year period from 2006 to 2015. The paper tests the hypotheses quantitatively. The results indicate the number of members negatively impacts earnings management, but the degree of independent members does not impact earnings management. Osemene et al. (2018) consider 14 commercial banks in the period of 2011–2016. The paper performs quantitative to check the research. The results show that the number of members of the Board and female members does not affect earnings management. Saiful and Dyah (2018) check 27 commercial banks and 10 Islamic banks in Indonesia over five years, from 2012 to 2016. A quantitative analysis is used to test hypotheses. The research demonstrates that independent members positively affect earnings management. Sadjiarto et al. (2019) conduct a study with 45 banks in the period of 2010–2017 on the Stock Exchange of Indonesia. The paper performs quantitative analysis to check the research. The paper elicits that independent members do not affect earnings management.

In Vietnam, research results on earnings management are carried out by some previous authors such as Thinh et al. (2022) and Tran et al. (2020). However, research on earnings management in the banking sector is still quite limited because the collected data have not been fully published by banks. Typically, Thinh et al. (2022) check on the earnings management of listed banks from 2015 to 2019. The paper examines the influence of factors of financial indicators on earnings management. Meanwhile, Tran et al. (2020) consider Board to earnings management of 183 listed enterprises in Vietnam from 2016 to 2020. Testing the factors of the Board to earnings management of listed banks has not been studied in Vietnam in the past time.

After reviewing previous studies, the paper finds that the studies looked at several different aspects of the factors affecting earnings management. Currently, there is no research examining the factors of corporate governance affecting the earnings management of listed commercial banks in Vietnam (abbreviated as listed banks). This problem is essential from the perspective of international integration to make information transparent. The purpose of the paper is to examine the factors affecting the earnings management of listed banks in recent times. Based on a synthesis of studies, the paper proposes variables of research models, specifically as follows:

1.1. The members of the Board

It is a representation of the number of members. Some studies show that the number of members has an effect on earnings management (Shen, 2016; Oladipupo, 2018; Osemene et al., 2018). Most of previous studies also show that the number of members negatively affects earnings management.

1.2. Independent members of the Board

It is a representation of independent members. Independent members do not participate in the operation of an organization. Many studies also confirm the relationship between independent members and earnings management (Cornett et al., 2008; Oladipupo, 2018; Saiful & Dyah, 2018; Sadjiarto et al., 2019).

1.3. The duality of the chairman of the Board and directors

It means the duality of the chairman of the Board and directors. It can help to monitor and operate an organization to ensure that the duality is implemented quickly and consistently in all decisions because all imperative decisions are implemented in a timely manner. Research shows that duality controls earnings management well. Some recent studies also have similar results that duality reduces the earnings management of business (Shen, 2016).

1.4. Meetings of the Board

It is to express the meetings of the Board in the fiscal year. Meetings of the Board can help with the consistent and timely processing and handling of critical operations-related information. If meetings of the Board are done regularly, there will be time to consider many issues, including earnings management monitoring. Some studies such as González and García-Meca (2014) and Kankanamage (2015) also suggest there is a relationship between meetings of the Board and earnings management.

1.5. The members of the Board with qualifications and expertise in economic fields

It is the basis for assessing the level of the Board. The Board should have general knowledge of accounting, and finance, as well as analytical and administrative capabilities. Qualified members are a factor that affects earnings management control because the Board has in-depth knowledge of the economic sector, which reduces earnings management. Previous studies are conducted that qualified members can contribute to the reduction of abnormal accruals and it is the basis for controlling earnings management (Kankanamage, 2015; Bala & Kumai, 2015).

1.6. Female members of the Board

It is the number of females in the Bard. It is a representative structure of the female gender when joining the Board. Female members are meticulous in numbers and have good skills in legal matters related to human resources, marketing, and communications. Gender diversity in the Board increases opinions so it makes more appropriate decisions (Lakhal et al., 2015). Several researchers review the consensual relationship between female members and information quality (Osemene et al., 2018; Azeez et al., 2019).

On the systematic basis of all variables impacting earnings management, several hypotheses of the proposed research model are as follows:

H1: *The larger the members of the Board, the lower the earnings management.*

H2: *The larger the independent members of the Board, the lower the earnings management.*

H3: *The larger the duality of the chairman of the Board and directors, the lower the earnings management.*

H4: *The larger the meetings of the Board, the lower the earnings management.*

H5: *The larger the members of the Board with qualifications and expertise in economic fields, the lower the earnings management.*

H6: *The larger the female members of the Board, the lower the earnings management.*

The paper inherits common variables from previous studies and is combined based on a survey of several experts of the Vietnamese Central bank to identify six independent variables. These are the variables of the assurance model that are consist-

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ent with Vietnam's regulatory requirements on Board as shown in the Law on Securities (2019) and the Law on Enterprises (2020). The research model with specific proposed variables is as follows:

$$EMB = \alpha 0 + \beta 1 \cdot SIZEit + \beta 2 \cdot INDEit + \\ + \beta 3 \cdot DUALit + \beta 4 \cdot MEETit + \\ + \beta 5 \cdot KNOWit + \beta 6 \cdot FEMAit + £it, \quad (1)$$

2. METHODOLOGY

The paper selects a sample size from 27 listed banks. The research uses time series from 2012 to 2021. The sample is investigated through the secondary market of data from financial statements, annual reports, and management reports of listed banks. The data source is collected from the websites of the State Securities Commission of Vietnam. Additionally, the study uses feasible generalized least squares to check the hypothesis of the research.

Methods to measure variables include earnings management and independent variables of the model.

Earnings management is an inherited model from Shen (2016). It is the commonly used model for determining the earnings management of banks. Thus, earnings management is measured by the risk variable adjusted for the credit provision expense ratio, specifically:

$$EMB = \frac{LLP / LOAN_{t-1}}{\sigma\, LLP / LOAN_{t-1}}, \quad (2)$$

where *EMB*: Earnings management; *LLPit*: Provision expense for credit risk/bank's net interest income (*i*) at year (*t*); *LOANt*-1: Total outstanding loans of the bank (*i*) at year (*t*-1); σ *LLP/LOANt*-1: Standard deviation *LLP/LOANt*-1 data from 2012 to 2021. *SIZE*: number of members of the Board; *INDE*: independent members of the Board; *DUAL*: the duality of the chairman of the Board and directors, the dummy is 1 if dual, and 0 otherwise; *MEET*: meetings of the B Board in the fiscal year; *KNOW*: Board members with qualifications and expertise in economic fields including finance, administration, and accounting; *FEMA*: female members of the Board.

3. RESULTS

According to the data in Table 1, the average earnings management is 0.1046, the maximum is 1.432 and the minimum is –0.2014. This shows a low level of earnings management of listed banks. The standard deviation of earnings management is 0.0021 and it is low so listed banks have no difference in earnings management. The number of members has an average of more than 6.412 members of the Board (the minimum is 6 members and the maximum is 10 members). The figures for members are quite relative. The standard deviation of the number of members is not significant, and this shows no difference gap between listed banks. Similar to the number of members, independent members also have no difference from listed banks. Independent members have an average of 1.504 members. The figures for independent members are also consistent. Independent members without any members are the minimum, while 5 members are the maximum. Duality of listed banks with an average of 0.3604 members, equivalent to 36.04%. The data shows that the duality of listed banks is relatively high. The standard deviation of the duality is also low. The meetings per year have an average of 16.812. The maximum number of meetings is 92, and the minimum is 14. The average number of qualified members is 4.618. The data show that the number of qualified members are quite high. Qualified members with 2 members are the minimum and 7 members are the maximum. However, the standard deviation of qualified members is relative to the other variables, so it elicits a difference in the qualified members. Females have an average membership of 1.824 members. The data are also relatively consistent. Females have a maximum of 4 members and a minimum of no members. Data related to the number of members, independent members, duality, and meetings are consistent with the Law on Enterprises (2020).

Table 1. Descriptive statistics

Source: Author's summary.

Variable	Obs.	Mean	Std. dev.	Min	Max
EMB	270	.1046	.0021	–.2014	1.432
SIZE	270	6.412	.1268	5	10
INDEP	270	1.504	.0041	0	4
DUAL	270	.3604	.0673	0	1
MEET	270	16.812	1.285	14	92
KNOW	270	4.618	1.2264	2	7
FEMA	270	1.824	.8604	0	4

Table 2. Correlations

Source: Author's summary.

Variable	EMB	SIZE	INDEP	DUAL	MEET	KNOW	FEMA
EMB	1.0000	–	–	–	–	–	–
SIZE	0.3081	1.0000	–	–	–	–	–
INDEP	–0.2406	0.2348	1.0000	–	–	–	–
DUAL	–0.2043	–0.3046	0.2147	1.0000	–	–	–
MEET	0.3109	–0.3108	–0.2068	–0.2405	1.0000	–	–
KNOW	0.2491	0.2971	0.3602	0.2764	–0.2947	1.0000	–
FEMA	0.1906	–0.2384	–0.2516	0.3107	0.2861	0.2473	1.0000

The results of Table 2 elicit the variables have a close correlation. All coefficients of the independent variables range from 0.1906 to 0.3108. All variables are all lower than 0.8, and this shows the model does not have multicollinearity (Hair et al., 1995). Variables that are positively correlated with earnings management such as the number of members, meetings, qualified members, and females, while the other variables are the opposite.

Table 3 show that there are three independent variables that have an impact on the earnings management of listed banks, including the number of members, meetings, and qualified members. All these variables have the same effect as earnings management. Accordingly, the number of members has the strongest influence, followed by qualified members, and finally meeting. The specific results of the research such as:

$$EMB = 0.1604 \cdot SIZE + \\ +0.0812 \cdot MEET + 0.1104 \cdot KNOW. \tag{3}$$

Table 3. Regression of feasible generalized least squares

Source: Author's summary.

EMB	Coef.	Std. err.	z	P > |z|
SIZE	.1604	.0218	3.81	0.000
INDEP	–.1184	.0137	–0.58	1.814
DUAL	–.0941	.0026	–0.26	1.604
MEET	.0812	.0162	3.05	0.000
KNOW	.1104	.0042	2.96	0.000
FEMA	.0374	.0038	0.62	1.563

Hair et al. (1995) propose the research is likely to have multicollinearity when the variables have multicollinearity greater than 5. The larger the multicollinearity value of a variable, the higher the multicollinearity in the model, and vice versa. The results from Table 4 affirm all the multicollinearity of the variables is less than 2. This can confirm that the model data do not have multicollinearity.

Table 4. VIF of the model

Source: Author's summary.

Variable	VIF	1/VIF
SIZE	1.41	0.8536
INDEP	1.72	0.6281
DUAL	1.25	0.9014
MEET	1.46	0.7803
KNOW	1.18	0.9347
FEMA	1.91	0.5412

4. DISCUSSION

The research results are similar to previous studies and expert opinion of the Vietnamese Central Bank when it is considered that the number of members, qualified members, and meetings affect the earnings management of listed banks

The number of members has a positive effect on earnings management, and this is consistent with current business conditions in Vietnam. The result is similar to previous studies by Shen (2016), Oladipupo (2018), and Osemene et al. (2018). When the number of members is high, it is assigned to control the activities of listed banks, in which earnings management is an issue that needs to be strictly managed. It also clearly demonstrates that the larger the number of members of the listed banks, the more effective the earnings management control. Therefore, the increase in the number of members is necessary for the near future of listed banks to strengthen control of earnings management.

Qualified members also have an effect on earnings management, and the result is similar to

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Kankanamage (2015), Bala and Kumai (2015). In the context of Vietnamese business, the banking sector is very important for regulating the country's capital, so it requires qualified members. When the Board is knowledgeable about economic issues, including accounting and finance, it can understand the accounting policies and information of financial statements. Information management well controlled by qualified members helps limit earnings management. It is evident when the qualified members affect the control of earnings management. In the coming time, Board members need to strengthen their professional knowledge in the field of economics in general and banking in particular, to be able to supervise earnings management.

Meetings of the Board have the same effect as earnings management, and this is similar to the previous studies by González and García-Meca (2014) and Kankanamage (2015). Meeting solves many business problems in the banking industry. Vietnam is one of the developing countries in Southeast Asia, so the banking system has many problems that need to be handled to make decisions. The meeting is meaningful and relevant to the business of listed banks. Through the comments of the meetings, Board discusses many issues to solve, including how to overcome earnings management. Going forward, listed banks should maintain regular and periodic meetings to discuss appropriate accounting policies to be applied to prevent earnings management.

CONCLUSION

Earnings management is the implementation of accounting policies to make adjustments to the earnings of listed banks. The paper does experiment with the research model and shows that corporate governance factors have an influence on earnings management in Vietnamese listed commercial banks. Accordingly, three factors positively influence and increase earnings management, including members of the Board, meetings of the Board, and the Board members with qualifications and expertise in economic fields. Members of the Board are the most influential factor, but meetings of the Board have the lowest effect on earnings management. The results also demonstrate that Vietnamese listed commercial banks made earnings management, but at low levels, for the past ten years. Whereby, the Vietnamese government agency should strengthen the regular and periodic inspection of financial statements to prevent timely behavior of earnings management of listed commercial banks.

AUTHOR CONTRIBUTIONS

Conceptualization: Dang Anh Tuan.
Data curation: Dang Anh Tuan.
Formal analysis: Dang Anh Tuan.
Funding acquisition: Dang Anh Tuan.
Investigation: Dang Anh Tuan.
Methodology: Dang Anh Tuan.
Project administration: Dang Anh Tuan.
Resources: Dang Anh Tuan.
Software: Dang Anh Tuan.
Supervision: Dang Anh Tuan.
Validation: Dang Anh Tuan.
Visualization: Dang Anh Tuan.
Writing – original draft: Dang Anh Tuan.
Writing – reviewing & editing: Dang Anh Tuan.

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