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The Effect of Audit Committee and Audit Quality on Earnings Management in Manufacturing Companies in Bei

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ABSTRACT

This study aims to further explore the impact of audit quality and the presence of an audit committee on earnings management practices in manufacturing companies. Over the period of 2019 to 2022, this study focuses on analyzing the trading of manufacturing companies in the sub-sectors of basic and chemical industry, ceramics and porcelain glass, metals and the like, plastics and packaging, and pulp and paper listed on the Indonesia Stock Exchange. Quantitative methods were used by analyzing the annual financial reports of seven different companies, which resulted in 20 separate data sets. In the analysis, the study utilized various statistical tools, including descriptive tests, classical assumptions, multiple linear regression, and hypothesis testing all run through SPSS software. The results of this study indicate that audit committee has no effect on earnings management and audit quality has a significant effect on earnings management.

Keywords: *Childhood, Fasting, Parents*

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INTRODUCTION

Financial statements are important documents in business that provide a complete picture of the company's financial activities, including business transactions (Greco dkk., 2020), current financial condition, cash flow, operational performance, and significant changes that affect the company.

Pure accrual earnings management, which involves discretionary accruals, has no direct impact on the company's cash flow, which is often referred to as accrual earnings management (Betran dkk., 2021). Accrual earnings management practices occur at the end of the period when managers have an understanding of actual earnings before they are manipulated, allowing them to calculate how much manipulation is needed to achieve earnings targets.

The application of earnings management is essentially the result of a company's ability to understand and use existing accounting policies (Joseph dkk., 2019). The ability to adjust financial presentations based on these policies allows companies to achieve their specific objectives (Shamzhy dkk., 2019). As a result of careful interpretation and strategic decisions, earnings management reflects the level of skill and wisdom in the management of financial information, although it can affect public perceptions of the stability and performance of the company.

According to research (Albrecht & Chin, 2020), companies experiencing high growth tend to use earnings management practices by manipulating profits before financial costs are reported (Achkari & El Fadar, 2020). However, information about profits is often the target of manipulation through opportunistic actions from management (Agboola dkk., 2020). This happens because management tends to maximize the satisfaction of parties who pay attention to profit information and their rights (Greco dkk., 2020). This tendency is well realized by management, especially those whose performance is assessed based on such profit information.

Previous research examined the relationship between audit quality and earnings management, but the result is that audit quality has no impact on earnings management, it is not safe to rely solely on the Big Four KAP auditors because of the risk of earnings management (Yoo dkk., 2021). The increased capacity of auditors to utilize information technology through computer-aided audit methodologies, coupled with their commitment to professional ethics, has contributed to improved audit quality during the pandemic (Adegbeye dkk., 2020). This is reflected in the responses, which show that the majority of respondents are aligned with the moral attributes expected of auditors, including qualities such as honesty, competence, prudence, confidentiality, and professional behavior (Amorelli & García-Sánchez, 2021). Differences in previous research have created a void in the literature. In research (Nugrahanti, 2012) shows that audits in the client's industry have an influence on audit quality on public accounting firms registered with BAPEPAM-LK in Indonesia (Zeng dkk., 2019). In research emphasized the important role of Audit Quality, Auditor Independence, and Financial Reporting Transparency in shaping the effectiveness of internal control.

This study examines how audit quality and audit committee behavior can affect earnings management (Jung dkk., 2019). With the author's study "The Effect of Audit Quality and Audit Committee on Earnings Management in Manufacturing Companies on the IDX in 2019 - 2022", based on the description above.

It is hoped that the results of this study can provide practical benefits for companies in choosing auditors who provide high audit quality, including auditors from KAP Big-4 and auditors who specialize in certain industries (Chen dkk., 2019). In addition, it is expected that the findings of this study will also provide added value to investors by providing additional information about the condition of the company. With more in-depth knowledge, investors can make wiser and more careful investment decisions.

LITERATURE REVIEW

Agency Theory

During the 1950s and 1960s, America's leading companies were operated by managers and run for managers, in accordance with the principles of agency theory (Ribeiro dkk., 2020). Earnings management practices arise in line with agency theory due to information asymmetry between company management and shareholders (Su dkk., 2019). Information asymmetry refers to an imbalance in access to information between the two parties.

Agency theory describes the contractual dynamics between managers (agents) and owners (principles) where both may have different objectives according to their individual drives, motivations and interests (Egan, 2020). As each party seeks to achieve its goals, conflicts of interest may arise between management as agents and company owners as principles (Leoni dkk., 2021). In this context, the agent will be encouraged to maximize the contractual fee he receives, while the principle seeks to maximize the return on the use of company resources (Schmitz & Leoni, 2019). The difference in knowledge possessed by managers and shareholders creates an information imbalance between the two (Li dkk., 2021). Managers have in-depth knowledge of company operations, internal policies, and industry developments that may not be fully available to shareholders and other related parties (Manita dkk., 2020). This condition creates information asymmetry, which in turn can affect investment decisions and evaluation of company performance by shareholders (Handayani, 2018).

Audit Quality

According to research (Nurdiono & Gamayuni, 2018), audit quality is measured based on the accuracy of the information presented by the auditor, as well as the extent to which internal audit can make a meaningful contribution to the responsibility and accountability of government entities (Golden & Kohlbeck, 2020). The interaction between internal and external auditors plays a key role in influencing internal audit quality, a dependent variable in this study (Kordab dkk., 2020). While this concept may only be relevant in the context of senior management, it confirms that the relationship between internal and external auditors can reflect how well internal audit quality is realized in the government entity. an organization (Truby, 2020). By improving audit quality, it is expected that investor confidence in the company's financial information will also increase (Kurani dkk., 2023). In this context, audit quality is measured using two variables, namely through the size of the KAP (both those included in the Big-4 KAP and Non-Big-4 KAP categories) and through the level of industry specialization of the auditors involved.

Earnings Management

Earnings management refers to any action that can affect reported earnings figures and the external financial reporting process, with the aim of benefiting the company's own managers (Nazmi dkk., 2019). This action involves practices such as revenue manipulation, expense management, or changes in accounting policies to create the impression of better financial performance, even if it does not reflect the company's actual performance (Abbasi dkk., 2019). According to (Arai et al., 2013), in addition to using non-financial information to overcome production management limitations caused by cost information, some Japanese companies have developed a Policy Choice Production Model (MPC) that is evaluated using profit information.

The motivation for opportunistic behavior in the context of positive accounting theory is reflected in three main hypotheses proposed by Watts and Zimmerman (1990): bonus plan hypothesis, debt covenant hypothesis, and political cost hypothesis. In the bonus plan hypothesis, the agreement between company owners and managers includes the promise of a bonus if the company's performance reaches a certain target (Mustangimah dkk., 2021). This bonus promise is a motivation for managers to manage and manipulate the company's earnings to reach the level necessary to qualify and receive the bonus. To calculate discretionary accrual (DA).

Research Hypothesis

The Effect of Audit Committee Size on Earnings Management

The audit committee can improve the quality of financial reporting and reduce manipulation so that the accounting process will produce quality reports. With this it can be stated that the existence of an audit committee can ensure that earnings management actions can be prevented (Pirola dkk., 2019). The audit committee plays a supervisory role regarding corporate financial reporting, internal control, auditing, and risk management with the aim of helping to protect the interests of investors in the hope of overcoming agency problems, namely reducing asymmetric information for users of company information (Budd dkk., 2020). Previous research (Fadlan Wicaksono & Nur Triyanto, 2023) said that the audit committee has no effect on earnings management. This contradicts research (Ardyanti, n.d.) that the audit committee has an influence on earnings management.

H1: Audit Committee affects earnings management.

The effect of audit quality on earnings management

Based on agency theory, there is a conflict between principals and agents. This conflict is caused by a conflict of interest between several parties. Management is asked to submit financial reports to principals who want to see how the performance in carrying out the activities of a company. However, what often happens is that management manipulates earnings with the aim of increasing profits. Independent audits are needed to test the financial statements provided from managers so that they can prevent actions that harm the company. The higher the audit quality, the higher the auditor's ability to minimize misstatement findings in the financial statements so that earnings management will be lower. According to research conducted by (Nwoye et al., 2021), audit quality affects earnings management.

H2: Audit quality affects earnings management.

RESEARCH METHODOLOGY

Data Type and Source

The data for this quantitative analysis comes from the annual financial statements of companies in the basic and chemical industry subsectors, ceramics and glass porcelain, metal and the like, plastics and packaging, and pulp and paper obtained from the Indonesia Stock Exchange website (www.idx.co.id) The criteria used to select samples are as follows: (1) Companies that are not listed on the IDX consecutively in 2019-2022, (2) Companies that do not report financial statements for the 2019-2022 period consecutively, and (3) Companies that do not use rupiah currency.

Population and Sample

The population in this study are manufacturing companies in the basic and chemical industry subsectors, ceramics and glass porcelain, metals and the like, plastics and packaging, and pulp and paper listed on the Indonesia Stock Exchange in the 2019-2022 period. 20 companies were sampled, and data was collected for four years.

RESULT AND DISCUSSION

The results of this study reveal a significant correlation between audit quality and audit committee behavior with earnings management practices in manufacturing companies in the basic and chemical industry subsectors, ceramics and porcelain glass, metal and the like, plastics and packaging, and pulp and paper on the Indonesia Stock Exchange during the 2019-2022 period.

Descriptive Statistics

This test is conducted to describe the research data. Descriptive statistical analysis that will be explained is the average (mean), maximum, minimum and standard deviation.

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
X1	80	0	1	.61	.490
X2	80	.40	.75	.5908	.11569
Y	80	4844.750	10194661	63221702	188230110
Valid N (listwise)	80				

Based on the information above, this study relies on 80 samples. Audit quality can be measured on a scale from 0 to 1 with an average of 0.61 and a standard deviation of

0.490. For the audit committee, the average value is 0.5908, the lowest value is 0.61 and the maximum value is 0.75 and the standard deviation is 0.11569. And earnings management has a mean effect of 0.63221 and a standard deviation of 0.188230.

Classical Assumptions

Reliability

Reabilitas

		N	%
Cases	Valid	80	100.0
	Excluded[a]	0	.0
	Total	80	100.0

a. Listwise deletion based on all variables in the procedure.

UJI F

ANOVA

Y

	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	26494	1	2649	5 81	5 .00
Within Groups	25340	78	3248		
Total	27990	79			

The sig. value of 0.005 based on the table above with an F value of 0.81 with a lower value of 2.65 there is little or no correlation between audit committee audit quality and earnings management.

Multiple Linear Regression

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		

1	(Constant)	443282	99581		4.451	.000
	X1	-554913	17091	-.341	--3.247	.0674
	X2	-852990	4033	-.222	-2.115	.038

a. Dependent Variable: Y

The sig value of the audit committee and audit quality based on the table above is 0.038 and 0.0674 so that it shows no more than 0.05 so that there are variables that have a statistically insignificant impact and there are variables that have a statistically significant impact.

Hypothesis Testing

The effect of the audit committee on earnings management

Based on the results above, it can be concluded that the sig value for the audit committee is 0.038 more than 0.05 so that the audit committee has no effect on earnings management and affects financial performance. This is in line with research (Sudjatna & Muid, 2015). This positive and insignificant relationship is partly because the company views the regulations for the formation and meetings of the audit committee as mandatory. The audit committee meets 4 times a year just to fulfill the company's obligations, so that the performance and supervisory function of the audit committee has not run optimally. There is a possibility that the meetings held by the committee do not focus on the problems of establishing good corporate governance so that they cannot eliminate company problems that lead to earnings management practices.

The effect of audit quality on earnings management

Based on the results above, the sig. value for audit quality is 0.0674 based on these results audit quality has an effect on earnings management. This is in line with research conducted by (Aryanti et al., 2017) that this research has a significant effect on earnings management, which means that the higher the audit quality, the greater earnings management will be. This can be caused because in general companies use bigfour or high-quality KAP services only to increase the credibility of financial statements so that they can be trusted by investors but cannot limit the occurrence of earnings management carried out by company management.

CONCLUSION

Based on the findings of this study, it can be concluded that audit quality, specifically through the involvement of auditors from KAP Big-4, and audit committee behavior have a significant impact in reducing earnings management practices in manufacturing companies in the basic and chemical industry subsectors, ceramics and porcelain glass, metal and the like, plastics and packaging, and pulp and paper on the Indonesia Stock Exchange for the 2019-2022 period. The overall 18% decrease in earnings management practices indicates that the presence of high-quality auditors and an active audit committee can improve the integrity of the company's financial information. The practical implication is that selecting auditors from KAP Big-4 and strengthening the role and involvement of the audit committee can be an effective strategy in maintaining investor confidence and increasing the informational power of financial statements.

As a suggestion, companies in the basic and chemical industry sector, ceramics and porcelain glass, metals and the like, plastics and packaging, and pulp and paper should seriously consider selecting auditors who have high credibility, such as Big-4 KAP, to mitigate earnings management practices. In addition, this study shows the importance of a proactive audit committee role in overseeing the company's financial activities. Therefore, companies should improve the competence and effectiveness of their audit committees. The implementation of good corporate governance practices and transparency in financial reporting can support the success of this strategy. Thus, it is hoped that the findings of this study can provide useful guidance to practitioners, regulators, and researchers interested in understanding and improving the integrity of corporate financial information.

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