B2.3_2019 Prevention of Earnings Management through Audit Committee

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Prevention of Earnings Management through Audit Committee and Audit Quality in the Award-Winning and Non-Winning Companies

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Abstract
Objective – The purpose of this study is to determine the role of the audit committee and the quality of external audits on the prevention of earnings management.

Design/methodology – The study was conducted using data from 34 winning and non-winning companies for Annual Report Awards (ARA) and Good Corporate Governance (GCG) Awards in 2008-2011, the period of the global economic crisis after the Enron and Worldcom cases in 2002 which triggered the strengthening of the role of the audit committee and external audit.

Results – This study found that two important components of the corporate governance structure; audit committee, and external audit, did not affect earnings management. However, by adding the Award control variable, it shows that there is a difference in the effect on earnings management between winners and non-award winners. It suggest that shareholders must continue to strengthen the role of the audit committee and external audit because earnings management is behavior and opportunity for management to deliberately change financial statements that are not easily proven except in very material quantities and over a period of several years. In addition, shareholders, creditors, and regulators should require company management to take part in ARA and GCG Award competitions.

Research limitations/implications – The limitation of this study is the small number of samples and the relatively short period of only two years.

Keywords: Audit Committee, Audit Quality, Earnings Management.

1. Introduction

The purpose of financial reporting is to provide financial information for an entity that is useful for decision making and allocation of resources (IASB, 2010). The results of previous studies indicate that the users most interested in financial statements are investment managers and banking officials to assess profitability, cash flow performance, and sustainability of the entity. But they also worry about the manipulation of financial statements that often occurs, because the entity manager has more knowledge and information than the owner so there is an incentive to behave opportunistically by intervening financial statements to achieve desired targets (Spohr, 2005; Healy & Wahlen, 1998; Weil, 2009). Earnings management behavior is contrary to the concept of faithful representation, one of the fundamental qualitative characteristics in financial reporting (Lerach, 2004; Luippold, 2009; Shuli, 2011; IASB, 2010). The consequences of earnings management are very detrimental, especially to the reliability, business reputation, the accounting profession, auditors, which ultimately lose investor and capital market confidence (Gerald, 2008; McEnroe, 2007). The 2001 Enron and WorldCom 2002 cases are popular in the literature because they have a global impact, but on the contrary, they re-establish awareness of the need for corporate governance mechanisms to prevent management opportunistic behavior in financial reporting (Alghamdi, 2012). The case of earnings management is relatively the

same, namely management records and reports higher revenues and profits than they should or expenses are recorded as assets (Bisri, 2013). The case of earnings management in Indonesia was recently revealed at PT Garuda Indonesia, which recorded long-term receivables as revenue in 2018, even though collectibility was still in doubt (okezone.com, 2019; detik.com, 2019). Another example, PT Waskita Karya was revealed to have manipulated the 2004-2007 financial statement earnings, even though it suffered a loss and capital deficit of Rp475 billion (Aliya, 2014). PT Kereta Api Indonesia in its 1998-2003 financial statements incorrectly recorded an expense to be an asset of Rp118 billion. In each case, the cause of financial reporting fraud is the failure of internal mechanisms to detect management opportunistic behavior (Monks and Minnow, 1990 in Strier, 2005). To improve the quality of corporate financial reporting, a system and structure of good corporate governance are needed (Miettinen, 2008). If attention to corporate governance increases, the quality of financial reporting increases (Bhattacharyya, 2012). Conversely a weak corporate governance structure results in low quality financial reporting and opportunities for earnings management or fraudulent financial reporting (Dechow, Sloan, & Amy, 1996; Beasley, Carcello, Hermanson, & Lapides, 2000; Carcello and Neal, 2000 in Ball, 2006).

The quality of financial reporting is related to the accuracy of the company in reflecting operating performance on future cash flow projections (Richardson & Tuna, 2008; Robinson & Munter, 2004; Gerald, 2008). The method of measuring the quality of financial reporting that is often used to detect earnings management is the Jones (1991) model that is modified by Dechow, Sloan, & Sweeney (1995) coupled with the Kothari, Leone, & Wasley (2005) model. For example, Ma, 2012; Bauer & Boritz, 2011; Chen & Liu, 2010; Garcı´a, Emiliano, & Pe´rez, 2010; Jacob & Honey, 2009; Prawitt, Jason, & Wood, 2009; Biddle, Gilles, & Rodrigo, 2009; Miettinen, 2008; Baxter, 2007. This model uses financial statement data to detect whether there are accounting accrual policies or judgments that are not related to cash inflows. This model is believed to have the best, reliable and more reliable test of earnings management measurements (eg, Ton, 2011; Ravenstein, 2012). Strengthening the system and structure of corporate governance is expected to overcome the problems of agency relationships, quality financial reporting and protect the interests of principals and stakeholders. Good corporate governance is also believed to overcome the problem of information asymmetry and ensure management actions for the benefit of the entity (Bushman & Smith, 2003; Miettinen, 2008; IASB, 2010). In addition, good corporate governance can also prevent and overcome earnings management, including preventing earnings manipulation and other financial reporting fraud (Cohen, Krishnamoorthy, & Wright, 2004; Krugman 2002 in Ball, 2006).

Financial reporting supply chain activities involve directors, boards of commissioners, audit committees, internal auditors, and external auditors who are complementary and interrelated (Hooper & Fornelly, 2010; Rezaee, 2003)Strengthening the role of the audit committee and external auditor is expected to contribute optimally in monitoring management activities (Adam, 1994; CAQ, 2010). The Audit Committee is representing the board of commissioners to ensure the integrity and reliability of the company's financial reporting (Salleh & Stewart, 2012). The audit committee has also been recognized globally as an important governance mechanism to ensure the integrity of financial reporting and audit processes (COSO, 2012). The results of the KPMG international survey in the 2013 Global Audit Committee Survey report found that almost all audit committees focus on financial reporting integrity risks including non-financial information. The results of previous studies include Sharma (2004); Bédard, Courteau, & Chtourou (2004); Klein (2002); DeZoort & Salterio (2001); Carcello and Neal, 2000 in Mohiuddin & Karbhari, 2006 found that audit committees reduce the risk of earnings management or fraud and improve the quality of audit report opinions. Important audit committee attributes are independence (Davidson, Goodwin, & Kent, 2005; Velte & Stiglbauer, 2011) clear mandate (Chtourou, Jean, & Courteau,

Earnings Management, Audit Committee, Audit Quality

2001), accounting and financial expertise (Carcello, Carl, April, & Terry, 2006; Velte & Stiglbauer, 2011), frequency of meetings (Miettinen, 2008). The results of the Garcı´a et al., 2010 study using attributes of the number of members and the frequency of audit committee meetings provide evidence of a negative impact on earnings manipulation.

Another governance component, external audit, has a role in supporting the quality of financial reporting. One important thing that is different from other professions, the public accounting profession has the responsibility to protect the public interest (IAPI, 2011). For investors, external auditing increases company transparency (Ashbaugh and Warfield, 2003 in Palmer, 2008) because it acts as an independent control mechanism for the agent's contract with the principal (Hussainey, 2009). The results of previous studies, for example, Lin & Hwang (2010) found a significant negative effect of audit quality on earnings management. Other researchers find that low external audit quality is associated with high levels of earnings management.

In various countries including Indonesia, one of the efforts to motivate management to implement good corporate governance is to hold annual financial report competitions (ARA) and corporate governance (GCG Awards). In the US, the Annual Report Competition (ARC) Awards are held which are participated by various countries from all over the world. Awards are given to entities that have the best annual financial statements and as indicators of excellence in accountability, ethical standards, transparency, and industry trust (). In Indonesia, the Annual Report Award (ARA) has been held since 2002. The ARA is supported by the Indonesian Accountants Association (IAI), the National Committee on Governance (KNKG), the Financial Services Authority (OJK), the Ministry of SOEs, the Directorate General of Taxation, Bank Indonesia, and IDX Indonesia stock exchange. The purpose of ARA is to improve the quality of information and corporate governance (iaiglobal.or.id, 2011). According to the OJK Chief Executive, ARA award recipients can be interpreted as having a quality financial report and a good corporate governance system (swa.co.id, 2014)

Based on the phenomenon of the importance of preventing earnings management by strengthening the system and structure of corporate governance, especially the audit committee and external audit, the identification of problems in this study is to find out (1) The effect of the role of the audit committee and the quality of external auditors on earnings management; (2) Is there a difference in the influence of the audit committee and the external auditor on earnings management in the ARA and GCG Award-winning companies.

2. Literature Review and Hypothesis Development

Agency Theory

The free market economy system opens up opportunities for investors to have a company without having to participate in managing the business. This model makes the separation between ownership and company control. Gaining the trust of the owner to manage the entity's resources often triggers conflicts of interest and relationship problems between the owner and the manager (Strier, 2005). Jensen & Meckling (1976) in agency theory states that "If both parties to the relationship are utility maximizers, there is a good reason to believe that the agent will not always act in the best interests of the principal". So, in a corporate context where owners and managers are rational, it is not possible to expect them to act to maximize the company's profit. Maximizing company profit and value is not possible at the same time by maximizing salaries, bonuses and other forms of compensation (Brennan, 2008). Separation of ownership also causes the principal to not have access to all information and cannot ascertain whether the agent's actions are in the best interest of the company and the owner. This problem is called the information asymmetry problem (Miettinen, 2008).

From the perspective of entity theory, capital owners have claims on the company's financial statements (IASB, 2008). Entities are like "black boxes" because agents

have more complete information and there is an incentive to enrich themselves by presenting substandard information by hiding actions that are contrary to the interests of the entity (Jensen & Meckling, 1976). This opportunity also triggers "moral hazard" which is a moral problem that is dangerous for the owner and other stakeholders (Scapens, 1985 in Adam, 1994).

From the lender's perspective, agency problems occur when agents "transfer" wealth, distribute dividends to shareholders, at the expense of investment projects that should benefit or reduce the debt burden. The literature has documented that companies that have large amounts of debt are more likely to conduct earnings management (Chow, 1982; Defond, 1992; Gul & Tsui 2001 in Miettinen, 2008).

Corporate governance

Information asymmetry requires a "check and balance" function in a corporate governance mechanism (Jensen & Meckling, 1976; Daniri, 2006; Miettinen, 2008). According to Mayer (1997)"Corporate governance is concerned with the ways of bringing the interests of the two parties into line and ensuring that firms are run for the benefits of investors. According to Chau (2011) "... Corporate governance is the overall control of activities in a corporation. ... to maintain the corporation's integrity, reputation and responsibility to its various constituencies. " Bhattacharyya (2012) emphasized, "It is difficult to separate corporate financial reporting from corporate governance". According to Miettinen (2008), one of the main objectives of corporate governance is to ensure the quality of corporate financial reporting.

In Indonesia, the governance structure model adheres to the two-tier board model, namely, there are Directors and Board of Commissioners (World Bank, 2011). CAQ (2010) states that management, boards of directors, audit committees, internal auditors, and external auditors are "supply chains" in financial reporting, which are complementary and interrelated in producing high-quality financial reporting to the public, including preventing and detect fraud. According to Rezaee et al. (2003), the Chief Financial Officer (CFO) is most responsible for the fair presentation of the financial statements. But in fact, the CEO and CFO as the main actors of corporate governance who should play the role of the main responsible for financial reporting that is free from misstatements are often involved in financial reporting fraud. For example, Beasley et al. (2010) in the Fraudulent Financial Reporting report: 1998-2007, revealed an increase in CEO and CFO involvement in fraud in the US. Kepsu research results (2012) found that the main actor in earnings management is the CFO, not the CEO.

However, as stated above, in the supply chain of financial reporting, the presence of an audit committee and external auditor are expected to make an optimal contribution in monitoring management activities (Adam, 1994; CAQ, 2010; Hooper & Fornelly, 2010; Rezaee et al., 2003).

Audit Committee

In response to a number of corporate governance failures in 2002, the Sarbanes Oxley Act 2002 was adopted, which strengthened the concept of the audit committee (Turley & Zaman, 2004; Cohen et al., 2004; Vera-Muñoz, 2005 in Kumar & Singh, 2012: 652). Section 301 SOA extends the responsibilities of the audit committee, relating to recruitment, fee setting, and monitoring of the audit process and results, as well as handling accounting and accounting control issues. According to (COSO, 2012) "The audit committee of the board of directors plays a critical role in the integrity of the company's financial reporting". The primary role of the AC is to assist the Board of Directors in overseeing the quality and integrity of the company's financial information (Ramanathan & Sim, 2010: 1).

PCAOB (2012) defines an audit committee "... is a committee (or equivalent body) established by and among the boards of directors of a company for the purpose of

overseeing the accounting and financial reporting processes of the company and audits of the financial statements of the company World Bank (2010: 20-21) states "The audit committee has the mandate to review financial reporting, ensure compliance with laws and regulations, oversee the internal audit, and report on risk and risk management to the BOC".

Various literatures state that the main role of the audit committee is to assist the board of commissioners to ensure the quality and integrity of information and corporate financial reporting. In detail, (Bapepam-LK, 2012) requires that the audit committee of one member must have an educational background and have expertise in accounting and finance, conduct meetings at least once every three months, being independent, and must understand the company's financial and business reports, understand the audit process, risk management and legislation, and improve competence. In addition, the activities of the audit committee must be disclosed in the annual financial report, including information on the appointment and dismissal of the audit committee on the website of the Indonesia stock exchange and the company website.

According to Mohiuddin & Karbhari (2006), the main attributes most widely used to measure the effectiveness of the audit committee's role are independence, expertise, level of crafts, and has many members. According to FRC (2012), the effectiveness of the audit committee includes the implementation of duties and responsibilities, having members, meetings, resources, remuneration, skills, experience, and adequate training. The independence of the audit committee has the potential to improve the quality and credibility of financial reporting. By including independent audit committee members minimize the possibility of financial cheating (Klein, 2002; Dechow et al., 1996).

The results of previous studies document that the audit committee's knowledge and expertise are directly related to the effective functioning of the audit committee (McDaniel, Roger, & Laureen, 2002; Beasley et al., 2010 and DeZoort & Salterio, 2001). Other researchers documented a positive relationship between the size of the number of audit committees and the quality of financial reporting. The level of diligence of the audit committee conducting meetings is very important to prove the effectiveness and integrity implementation of responsibilities.

External Audit

According to Arens et al. (2012) "Auditing is the accumulation and evaluation of evidence about information to determine and report on the degree of correspondence between the information and established criteria". According to Wallace, 1980 (in Roussy, 2011) "The audit fulfills three explicit demands: a demand for a monitoring mechanism, a demand for information production and demand for insurance to protect against losses from distorted information".

The most common way to obtain reliable information is to use information that has been audited. Decision making based on information that has been audited is considered more complete, accurate, and unbiased (Arens et al., 2012). In the audit standard (SA) Section 110 paragraph 01, IAPI (2011) states that the purpose of financial statement audits is to express an opinion about the reasonableness, in all material respects, financial position, results of operations, changes in equity, and cash flow according to Financial Accounting Standards In ISA 200.11, Tuanakotta (2013) states that the overall objective of the auditor is to obtain reasonable assurance regarding whether the financial statements are free of material misstatements, due to fraud or errors, thus allowing the auditor to give an opinion.

In essence, an external audit is a control mechanism for contracts between agents and principals. "Demand for audit arises from information asymmetry and agency conflicts between corporate managers, outside investors, and intermediaries" (Hussainey, 2009). The important role of external audit is to increase corporate transparency "External audits play a strong corporate governance role and are in-

strumental in supporting transparent financial reporting" (Ashbaugh & Warfield, 2003 in Palmer, 2008). Knechel (2009) states that the quality of audits and the quality of financial reporting have become issues that have received much attention since the scandals and economic events of the past few decades. According to Arens et al., 2012) to produce a quality audit, the auditor must be qualified and competent, so that he knows the type and amount of audit evidence that must be collected during the audit until a correct conclusion is reached. The auditor must also have an independent mental attitude. According to the chairman of IAASB Schilder (2013), audit quality can be achieved when the auditor's opinion on financial statements can be trusted or reliable because of the adequacy of obtaining appropriate audit evidence. The Public Company Accounting Oversight Board (PCAOB) (2013) as the KAP supervisory board formed by SOX 2002 defines auditor quality indicators that ... audit quality as meeting investors' needs for independent and reliable audits and robust audit committee communications on financial statements, including related disclosures; assurance about internal control; and going concern warnings. The PCAOB (2013) audit quality definition aims to "meeting customer needs".

From an investor perspective, audit quality is determined by audit report factors, auditor reputation, and relevance/expectations of the audit. Not only auditors but also management plays a very important role in improving audit quality. Audit quality can be seen as a collaboration between auditors and management to correct report misstatements. According to World Bank (2011) Indonesia, which has more than 400 KAPs, only a few KAPs that fully (high level) comply with the audit standard requirements, so investors tend to trust the financial statement information audited by the big four KAPs. According to DeAngelo (1981) Big-4 KAP is a proxy for audit quality. The firm size determines audit quality because it has technological capabilities, audit procedures and sampling, as well as adequate levels of independence from clients, so the probability of finding irregularities becomes greater. In addition, large KAPs avoid failing to find fraud because it will harm their reputation. Large KAP provides quality because of the amount of a large fee and does not depend on one client.

So most companies decide to choose Big4 KAP because of their reputation and credibility so that it gives more value to the company (Weiner, 2012). Francis, 2004 in Palmer (2008) argues that the financial statements audited by large KAPs are of higher quality. Large KAP have the top rank because they have a global network, are consistent in quality, have better auditors and audit methodologies than other KAPs (Tuanakotta, 2013).

Earnings Management

Schipper, 1989 in Spohr (2005: 25) defines earnings management as "... a purposeful intervention in the external financial reporting process, with the intention of obtaining some private gain". According to Healy & Wahlen (1998): "Earnings management occurs when managers use judgment in financial reporting ... to change financial reports to either mislead some stakeholders about the underlying economic performance of the company ...". In essence Luippold (2009) quoting from several other authors, states "Earnings management refers to financial reporting practices designed to achieve desired or favorable financial results (e.g., smoothing earnings, meeting earnings targets). Davidson et al. (2005) in Kepsu (2012: 25-26) argues that earnings management is "... the process of taking deliberate steps within the constraints of generally accepted accounting principles to bring out the desired level of reported earnings". According to Fong (2006: 81) earnings management is a manipulative effort to cover the company's actual economic performance. The Certified Fraud Examiners (CFE) Association in Dechow & Skinner (2000) defines earnings management as "... the intentional, deliberate, misstatement or omission of material facts, or accounting data, which is misleading ... would cause the reader to change or change. his or her judgment or decision." According to the SEC in Shuli (2011) earnings man-

agement is a fraud when the abusive management of the earnings is a material and intentional misrepresentation of results.

Accrual accounting is not an exact science. To produce income statement figures using accounting assumptions and estimates. Instead, investors and creditors assess the health of the company based on company profits. Therefore, performance is often made by relying on earnings management practices (http://thestudentcpa.com, 2010). So in essence earnings management is related to behavioral orientation and management opportunities, especially CFO who intentionally change and exploit earnings reports (Weil, 2009: 2; Kepsu, 2012)

Shuli (2011) states that users of financial statement information must try to find indications of earnings management (Richardson & Tuna, 2008). Some red flags are revenue growth, accounts receivable, inventory, operating costs, and capitalization of large amounts of costs that are far above the industry average (Stowe et al, 2002 in Richardson & Tuna, 2008). In Statement of Auditing Standard (SAS) No. It has been suggested that the most effective indicator is mainly extraordinary growth and profit but negative cash flow. A simple way to isolate total accrual earnings management is by separating accrual earnings into the accrual component and cash flow (Richardson & Tuna, 2008). Ibrahim (2005) suggested that the earnings management detection model that is often used is the Healy model (1985), the DeAngelo model (1986), the Jones model (1991), and the Jones model (1991) modified by Dechow et al. (1995). The Jones model (1991) modified by Dechow et al (1995) which subtracts changes in accounts receivable (ΔARit) from changes in income to account for non-cash income manipulation in the test period:

$$DAC_{it} = TAC_{it-1}/A_{it-1} - [a_{i1}\ (1/A_{it-1}) + b_{i1}\ (\Delta REV_{it} - \Delta AR_{it}\ /A_{it-1}) + b_{i2}\ (PPE_{it}/A_{it-1})]$$

This model is the most reliable accrual discretion estimation model and the smallest measurement error when manipulation occurs through receivables or non-cash income Ton (2011: 35). Likewise, Ravenstein (2012) concluded that only the Jones model (1991), especially the Jones model (1991), was modified by Dechow et. al (1995) is a more reliable model. Kothari et al. add one constant variable return on assets (ROA) to the Jones model (1991): $NDA_{i,t} = a_1\ [1/A_{i,t-1}] + a_2\ \Delta REV_{i,t} + a_3\ PPE_{i,t} + a_4\ ROA_{i,t}$ where: $NDA_{i,t}$ is the non-discretionary accrual of company i in year t. The reason for entering ROA is to compare the performance of accrual discretionary performance. When ROA is included as a variable, accrual discretion is matched to company performance. The ROA for the Jones (1995) modification model in addition to the independent variables makes the conclusions are drawn more reliable (Ravenstein, 2012). The Jones modification model can be used both in research with time-series data and cross-sectional analysis, for one particular time, a company is compared to its industrial branches (segments) (Ton, 2011)

Conceptual Framework

This study focuses on testing the effect of two components of corporate governance, namely the audit committee and external audit on earnings management. In relation to earnings management, the audit committee together with external auditors discuss various important issues during the audit, including important accounting and audit considerations, review the level of financial reporting errors identified, and obtain management explanations, and question the reasons for errors that have not been corrected, review audit representation letters before signing and management letters and monitor management's response to the findings and recommendations of external auditors, and assess the effectiveness of the audit process. Davidson et al. (2005) prove that independent audit committee members are significantly associated with earnings management decline. Garcı´a et al. (2010) documented that the number of members and the frequency of audit committee meetings had a significant negative impact on earnings manipulation. Chtourou, Jean, & Courteau (2001) find evidence

that earnings management is negatively related to the independence of audit committee members, a clear mandate about the task of overseeing financial statements and external audits. Velte & Stiglbauer (2011) prove a significant negative relationship between independence and financial expertise of audit committee members on earnings management and accounting errors. Miettinen (2008) found that the frequency of audit committee meetings contributed to the quality of financial reporting and the quality of external audits.

Lin & Hwang (2010), from the results of a meta-analysis, found a negative relationship between earnings management and audit quality. Bauer & Boritz (2011) found a relationship between earnings quality and corporate reporting awards (CRA). Other studies of winners and non-winners of the 2002 National Annual Corporate Report Award whose shares are listed on the Bursa Malaysia find the quality of financial reporting can be explained by the audit committee and external audit variables. Based on the framework that has been described, the hypotheses that can be formulated in this research plan: (H_1) The audit committee and external audit have a negative effect on earnings management; (H_2) There is a difference in the influence of the audit committee and external audit on earnings management in the winning companies with non-ARA award winners and/or GCG Awards.

3. Research Method

The research method used in the research is explanatory through hypothesis testing to investigate and predict relationships between variables (Sekaran & Bougie, 2010). The audit committee independent variable is measured by indicators of educational background and accounting and financial expertise, frequency of meetings, number of members, and clarity of mandate following previous research including Lin, Jason, & Qingliang (2008), Zain, Mat, & Goodwin (2004), Miettinen, (2008), Chtourou et al., (2001), Salleh & Stewart (2012). External audit variables are measured by the firm size of the Big-4 KA as an indicator of audit quality (DeAngelo, 1981; Zerni, 2009; Tuanakotta, 2013). The dependent variable of earnings management (EM) is measured using the Jones model (1991) modified by Dechow et al. (1995) and combined with the return on assets (ROA) of the previous period as suggested by Kothari et al. Following previous research (Carcello et al., 2006), Miettinen, 2008, Chen & Liu, 2010).

Factual data from the audit committee, external audit, and earnings management are sourced from secondary annual reports available at the Indonesian Capital Market Directory (ICMD) and the web www.idx.co.id owned by PT. Indonesia stock exchange. Whereas information on winning the Annual Report Award (ARA) and GCG Award were obtained from SWA magazine, bapepam.co.id. The population of this study is all companies listed on the Indonesia Stock Exchange. The target population is the Annual Report Award (ARA) and GCG Award recipients in the 2008-2011 period to prove that after the 2008 crisis, by strengthening the corporate governance component of the audit and audit committee external companies can improve the quality of financial statements. Data analysis using multiple regression analysis methods.

4. Result and Discussion

Based on available annual financial statement data, financial statements that meet the criteria are 34 non-financial service companies that have received awards and non-recipients of ARA awards and / or CG Awards in 2008-2011.

Data analysis aims to see whether the data used in research meets the assumptions of multiple regression analysis methods (multiple regression). The research data were 34 companies listed on the Stock Exchange consisting of 17 companies that won ARA / GCG Awards during 2008-2011 and 17 non-winner

companies taken by random sampling. The relatively small number of samples is partly because participants and ARA and GCG Award winners for non-financial services companies are relatively small, some data is not available in the ICMD directory or not yet listed on the IDX, and there are some financial statement data only in foreign currencies. Financial service companies (banks/insurance/ finance) are excluded from the sample because as stated by Suda, Keiichi, & Hitoshi (2005) the accrual policy format differs from non-financial services which result in different earnings management calculations. Based on the results of the analysis, the research data meet the normality, multicollinearity, homoscedasticity, autocorrelation, and linearity test requirements. Therefore research data can be used for further data processing and analysis.

Descriptive Research Data

Detection of earnings management in this study uses the model of Jones (1991) modified by Dechow et al. (1995) and added to the ROA variable according to Kothari et al. (2005). The first step is to calculate the total accruals (TAC). Total accruals are net income minus cash flow from operations. The second step, based on the total accruals, created a regression model based on the Jones (1991) model that was modified by Dechow et al. (1995) and adjusted to the ROA model of Kothari et al. (2005)The resulting regression model is as follows:

$$TAC_{it}/A_{it-1} = -0{,}104 - 23.155(1/A_{it-1}) - 0{,}018(\Delta REV_{it} - \Delta REC_{it})/A_{it-1} + 0{,}008\,(PPE_{it}/A_{it-1}) + 0{,}879\,ROA_{it} + \varepsilon_{it}$$

The third step, the residual regression value (ε_{it}) as an estimate of management accrual discretion (DAC_{it}) for each company is calculated using the following formula:

$$DAC_{it}/A_{it-1} = TAC_{it}/A_{it-1} - [-0{,}104 - 23.155(1/A_{it-1}) - 0{,}018\,(\Delta REV_{it} - \Delta REC_{it})/A_{it-1} + 0{,}008\,(PPE_{it}/A_{it-1}) + 0{,}879\,ROA_{it}]$$

The DAC_{it}/A_{it-1} (accrual discretion) value of the formula is used for further analysis, to see the effect of the audit committee (AC) and external audit (EA) on earnings management (EM).

The results of testing the sample data as set out in table 1 show that the average audit committee meeting (ACMEET) was 8.26 times in one year. The number of members of the audit committee (ACJMLH) varies between 3 to 8 people with an average of 3.7. The ratio of audit committee members who have education and experience in financial accounting (ACLTR) is 0.4797, meaning an average of 47%. While companies that use external auditors Big-4 KAP are 0.53 or 53%. Earnings management shows an average of negative residual or abnormal accruals of -0,038779.

Table 1. The statistical description of audit committee indicators, audit committee variables (AC), External Audit variables (EA), Earnings management (EM)

	N	Minimum	Maximum	Mean	Std. Deviation
ACLTR	34	,00	1,00	,4797	,24796
ACCHTR	34	,00	2,60	1,5702	,91688
ACMEET	34	,00	10,25	2,0662	2,21078
ACJMLH	34	1,00	2,67	1,2353	,43862
EA	34	0	1	,53	,507
EM	34	-,3845	,2324	-,038779	,1334849

Hypothesis Testing Results

The results of the first hypothesis testing the influence of the audit committee and external audit on earnings management, as shown in table 2 Anova which simultaneously tests all variables, shows that the F test value of 1.193 with the value of Sig. 0.317. These results indicate that at 95% confidence level (α = 0.05) and 90% (α =

JAROE
VOL. 2(2)

0.10) the regression model shows that based on sample data, the audit committee and the quality of the external audit have no effect on earnings management.

Table 2. ANOVA for n= 34

n	Model	Sum of Squares	df	Mean Square	F	Sig.
34	Regression	,042	2	,021	1,193	,317
	Residual	,546	31	,018		
	Total	,588	33			

The second hypothesis test results by adding the Award variable as a dummy variable that has a value = 1 for companies that win ARA/GCG Award and value = 0 for non-ARA/GCG Award companies are tested to determine whether there are differences in the influence of the audit committee and external audit committee on management profit between winners and non-ARA/GCG award winners. As shown in table 3 that overall, the test results F = 2.297 with the Sig. = 0.98 which means that at a confidence level of 90% (α = 0.10) statistically shows that the influence of the audit committee and external audit on earnings management is different between the winning companies and the non-awarding ARA/GCG Award recipients.

Table 3. ANOVA n= 34 with Award's dummy variable

	Model	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	,110	3	,037	2,297	,098
	Residual	,478	30	,016		
	Total	,588	33			

Table 4 shows the coefficient of determination R2 = 0.187 which means that 18.70% of earnings management can be explained by the role of the audit committee and external audit by adding a dummy Award variable.

Table 4. Model Summary n= 34 with Award's dummy variable

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
	0,432	0,187	0,106	0,12625	2,363

However, partially through the t test as shown in table 5, only the Award variable statistically shows the effect on earnings management (t = 2.062; Sig. = 0.048 <p = 0.05). While the audit committee (AC) and external audit (EA) were not statistically significant (t = -733, p> 0.05 and t = -1.490, p> 0.05). The results of the second hypothesis test prove that the effect on earnings management is different between the winning and non-award winning ARA/GCG companies.

Table 5. Coefficients Regression Results n = 34 with dummy variables

	Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-,025	,046		-,542	,592		
	AC	-,007	,009	-,160	-,733	,469	,571	1,752
	EA	-,067	,045	-,253	- 1,490	,147	,941	1,063
	AWARD	,116	,056	,440	2,063	,048*	,597	1,675

The results of this study provide evidence of the audit committee and the quality of the external audit has no effect on earnings management. However, adding the Award variable shows that there is a difference in the effect on earnings management for ARA and / or GCG Award-winning companies. The findings of this study as a whole are not in line with the initial expectations that two important components of corporate governance namely the audit committee and external audit can significantly

prevent earnings management. But as stated earlier, earnings management is management behavior and opportunity that intentionally changes financial statements that are not easily proven in a short time. In general, the case of earnings management was revealed several years later and in a relatively long period of time. In addition, earnings management behavior is generally revealed when earnings management is very material. Audit quality with big-4 KAP proxy which also has no effect on earnings management. This is alleged because the focus of the financial audit is to provide audit opinion based on the examination of the evidence of financial statements and the conformity of accounting standards and not the assignment of investigative audits to look for evidence of fraud. If in a financial audit no material findings are obtained, the auditor gives an unqualified opinion. The results of the study found no influence of the role of the audit committee on earnings management in line with recent research such as Murhadi (2009), Ulina, Mulyadi, & Tjahjono (2018), Lestari & Murtanto (2017), Matjari (2009). While the findings of the absence of the influence of audit quality on earnings management are also the same as the results of research by Lestari & Murtanto (2017). However, the results of this study provide evidence that increasing the Award control variable can have a different effect on earnings management.

Overall, the results of the study have not been able to provide convincing evidence that the mechanism of corporate governance structure represented by the audit committee and external audit can hamper earnings management. The weakness of this study is that the sample data is used a little with not a long period, and does not include other variables that are theoretically very important in the case of earnings management, namely the finance director and president director.

5. Conclusions and Suggestions

Referring to the results of the analysis, hypothesis testing, discussion, and research findings, it can be argued that the results of this study provide evidence that the committee and external audit either partially or as a whole have no effect on earnings management. However, the ARA or GCG Award-winning companies have different effects on earnings management. Based on these empirical findings, the Award variable is one of the important factors influencing the prevention of earnings management. Thus, it is recommended that regulators, shareholders, and creditors require companies to follow the ARA and GCG Awards to prevent earnings management.

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PAGE 4

PAGE 5

PAGE 6

PAGE 7

PAGE 8

PAGE 9

PAGE 10

PAGE 11

PAGE 12

PAGE 13

PAGE 14

PAGE 15