THE EFFECT OF CHARACTERISTICS OF AUDIT AND BOARD OF DIRECTORS ON REAL EARNINGS MANAGEMENT IN COMPANIES LISTED ON THE INDONESIA STOCK EXCHANGE

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ABSTRACT

This study aims to examine the effect of the characteristics of the audit and board of directors on real earnings management. In terms of limiting real earnings management by a company manager, there are characteristics of audit. Characteristics of the audit are the most important part in the structure of a company and government. An audit that works efficiently and well will generate positive corporate profits. This study uses data from all companies listed on the Indonesia Stock Exchange (IDX) which include annual reports from 2016 to 2020. Sampling of data was done by purposive sampling technique. This study combined the research object and one time dimension. This research was conducted using panel data regression test based on data that had been collected using SPSS and Eviews 10 software. The best model chosen for this research model was the Fixed Effect Model. The results showed that the characteristics of the audit and board of directors has no influence on the dependent variable real earnings management which could be seen from the probability value of the T test results. Meanwhile, the independent director has a significant positive on real earnings management.
Keywords: Real Earnings Management; Characteristics of Audit; Board of Directors; Indonesia Stock Exchange (IDX)
JEL Classification: M41,M42,M51

1. INTRODUCTION

Recently, there have been frequent accounting scandals regarding global corporate management and financial reporting (Leuz & Wysocki, 2016). Studies that provide insight into real earnings management and audit quality are much more relevant for research, because real earnings management is one of the accounting scandals committed by managers.(Sitanggang et al., 2019). Where audit quality has an important role in checking the real earnings management. In addition to real earnings management, accrual earnings management is one of the accounting scandals, but managers decide to use real earnings management for the short term.

The main idea in using earnings management is that profit targets are prioritized today (Sitanggang et al., 2019). Where the profit of the company must target its profit as high as possible in order to ensure the sustainability of the company. Because it can bring positive value to the company, shareholders will potentially be exposed to greater costs in real earnings management than accrual earnings management due to managers who behave tend to prefer short-term business decisions than long-term(Sitanggang et al., 2019). Managers

decide a decision that can affect the company's income is not easy so that if the manager decides on something related to the company's income, of course it doesn't run from financial reports that explain everything related to finance.(Sitanggang et al., 2019).

Audit quality is no less important in a company, auditors are independent parties who provide assurance on the quality of accountants that reflect managerial discretion over reporting earnings (Al-Shaer et al., 2017). Auditors who can assess material misstatement of reports include high-quality auditors, but if an auditor asks to revise or recreate existing financial statements, the quality of the auditor is considered low due to assisting or cooperating with the company in presenting financial statements that are has been revised. Investors view that companies that have the ability to generate profits certainly have earnings quality that can measure the quality of auditors, whether low or high. From accrual earnings management which can be negatively affected by the manager whose goal is to manipulate profit figures,(Gao et al., 2017).

The audit committee is a tool in managing companies that seek to improve the integrity of financial statements. The audit committee has the authority which is to oversee the company's financial statements, audit process, disclosure and account certification related to the board of directors and is also responsible for reviewing the company's financial statements and ensuring that describing fair reports is in accordance with the company's actual performance.(Mishra & Malhotra, 2016).

2.   LITERATURE REVIEWS

Real earnings management includes earnings engineering carried out by managers with real activities such as abnormal operating cash flows, abnormal production costs, and abnormal discretionary costs. Which is also a documented accounting phenomenon and is also an economic adjustment notified by the company to internally to serve some interest or to control the outcome of the agreement. High-quality earnings provide some additional information about the features of a company's financial capabilities that relate to certain decision makers or makers in building those decisions. Most previous studies measure earnings management with real earnings management and accrual earnings management (Inaam & Khamoussi, 2016). According to Astami, et al. (2014) describing that managers' actions related to surplus free cash and consequently focusing on choices in accounting techniques aimed at earnings management, suggest that there are observations or disciplinary actions by executor of outside interests and channel that is less effective, some managers may prefer to invest in projects that have a marginal or even negative NPV. In addition, managers can choose projects that can benefit themselves or only to please themselves. This can happen because managers know that detecting the agency costs of cash flows when investing with a negative NPV is very difficult to detect.

Audit Quality and Real Earnings Management

External audit has a high quality acting as a monitoring mechanism and the value of monitoring will be higher if the corporate governance mechanism is weak (Houqe et al., 2017). High audit quality is associated with low earnings management and high earnings quality, where many companies using high quality auditors will expect to have smaller abnormal accruals, because high quality auditors will more easily detect abusive earnings management and reports. with material misreporting. Few companies have an advantage in terms of clients and audit fees, audit firms that have high quality certainly have a stronger motivation in reducing litigation risk and protecting or maintaining their reputation. From this point of view, one would expect to observe a negative relationship between the magnitude of earnings management and audit quality (Khalil & Ozkan, 2016). And it is supported by Houqe, et al. (2017), Inaam & Khamoussi (2016), Khalil & Ozkan (2016), Rusmin, et al.

(2014), Gumanti, et al. (2015), Sellami & Fakhfakh (2013), Lestari & Aeni (2019), and Alzoubi (2016)

H1: The audit quality is statistically significant and negatively related to real earnings management.

Audit Committee Expertise and Real Earnings Management

To make it easier for companies to see an effective financial reporting system, it is better for companies to have an audit committee that has experience or expertise in finance and accounting (SUSANTO & PRADIPTA, 2020). Of the total members of the audit committee, there is at least one member who can be in the field of accounting or finance and the chairman of the audit committee can at least read financial statements. To prevent manipulation, so that there is at least one member of the audit committee who is in the accounting or finance field and it is better if all of them have experience in the accounting or finance field (Mishra & Malhotra, 2016). This is supported by Agyei-Mensah & Yeboah, (2019), Juhmani, (2017), Suprianto, et al. (2017), Albersmann & Hohenfels (2017), Sylvia Veronica Siregar (2018), and Rajeevan & Ajward (2019).

H2: Audit committee expertise is statistically significant and negatively related to real earnings management.

Audit Committee Tenure and Real Earnings Management

An audit committee who occupies the position of commissioner will have more influence on the behavior of managers, because an audit committee has functions and duties in overseeing the financial reporting system and also serves as a commissioner so that the percentage of managers' actions in carrying out earnings management for company owners will be small (SUSANTO & PRADIPTA, 2020). In addition to the audit committee that has a position on the commissioner, the time or length of the audit committee working in the same field with long experience can affect real earnings management which can prevent or examine financial statements more carefully in accordance with their experience in the long term (J et al., 2017). And this is supported by the research of Agyei-Mensah & Yeboah (2019).

H3 : Audit committee tenure is statistically significantly and negatively related to real earnings management.

Size of Audit Committee and Real Earnings Management

The existence of a large number of audit committees will make it easier for companies to present more relevant financial reports and reduce the implementation of real earnings management and the financial statements can be presented in a more practical form (SUSANTO & PRADIPTA, 2020). If a sufficient number of audit committees already have the main task being carried out, it will prevent real earnings management. the audit committee is independent and should not be influenced by others, the number of audit committees is very influential nor should there be only one person at least three people (Agyei-Mensah & Yeboah, 2019). And this is supported by Almarayeh et al. (2020), Juhmani (2017), Albersmann & Hohenfels (2017), and Rajeevan & Ajward (2019).

H4: The size of the audit committee is statistically significant negative related to real earnings management.

Audit Committee Meeting and Real Earnings Management

Audit committee meetings that are routine or always held will affect the implementation of real earnings management, the more frequency of meetings held by the audit committee, the more difficult opportunities for management to practice real earnings management, so that audit committee meetings can reduce managers' actions in manipulating financial statements (SUSANTO & PRADIPTA, 2020). The number of meetings held by the audit committee should be at least four times a year, to tighten the checking of the annual report and should be more meetings held the less real earnings management will occur

(Agyei-Mensah & Yeboah, 2019). This is supported by Albersmann & Hohenfels (2017) and Rajeevan & Ajward (2019).

H5 : Audit committee meeting is statistically significant and negatively related to real earnings management.

Board of Directors and Real Earnings Management

The board of directors is a corporate governance tool that is said to be quite important in the company so that the board of directors on a large scale will facilitate the manipulation of financial statements, the board of directors can ensure that managers carry out their duties in accordance with the interests of the board, and therefore, the number of the board of directors which will make it easier to practice real earnings management (SUSANTO & PRADIPTA, 2020). However, a small number of directors will make it easier to manipulate financial statements due to decisions made by only one or two people. if the board of directors is very large, it will be difficult to make a decision due to differences of opinion from the various directors per each division, unless they will be united in manipulating the financial statements (Boulila Taktak & Mbarki, 2014). It is supported by Alzoubi (2016), Mersni & Ben Othman (2016), and Rajeevan & Ajward (2019).

H6: The board of directors are statistically significant negative relationship with real earnings management.

Independent Directors and Real Earnings Management

Independent directors include boards of directors outside the company so that they will be very less able to find information that occurs within the company internally, and therefore, independent directors will make it easier for internal management to practice earnings management without the knowledge of the independent director (SUSANTO & PRADIPTA, 2020). Independent directors don't always pay attention to the internals of their own company, but only knowing the outside of the company doesn't always hear anything. With this, of course, it will make it easier for real earnings management to occur in the company. especially if there are more than half of all directors who are independent directors but that is very rare. This is supported by the research of Boulila Taktak & Mbarki (2014).

H7: Independent directors are statistically significant and positively related to real earnings management.

3. RESEARCH METHOD
3.1. Data

Obtaining a sample of this research data using data that meets the required requirements with purposive sampling technique. The information used is the financial statements listed on the IDX for 2016-2020 using secondary data. Financial reports can be viewed through http://www.idx.co.id. For data acquisition, the researcher applied documentation and literature study techniques. Documentation techniques can be obtained through financial statements that meet the requirements needed to prove how many data gaps are obtained. The literature study technique was obtained from working papers and foundations related to the problems studied.

Dependent Variable

Real earnings management is the dependent variable in this study and uses three measurement proxies for real earnings management, namely (Sitanggang et al., 2019):

1. Abnormal operating cash flow (Abn_Cfop)

   Abnormal operating cash flow is profit manipulation carried out by the company in operating cash flows which have relatively lower cash flows than they should. Abnormal operating cash flow is calculated as the difference between the actual cash flow from operations and the expected rate for each year of the company.

$$\text{Cfop}_{it}/\text{Assets}_{i,t-1} = a_{1t}(1/\text{Assets}_{i,t-1}) + a_{2t}(\text{Sales}_{i,t}/\text{Assets}_{i,t-1})$$

$$+ a_{3t}(\Delta\text{Sales}_{i,t}/\text{Assets}_{i,t-1}) + \lambda_i + e_{it},$$

2. Abnormal discretionary fee (Abn_Discexp)

   Abnormal discretionary costs are profit manipulation through research and development costs, sales costs, advertising costs, administrative and general costs. Abnormal discretionary expense is calculated as the difference between the actual and expected level of discretionary spending for each year of the company.

$$\text{Discexp}_{it}/\text{Assets}_{i,t-1} = b_{1t}(1/\text{Assets}_{i,t-1}) + b_{2t}(\text{Sales}_{i,t-1}/\text{Assets}_{i,t-1}) + \lambda_i + e_{it},$$

3. Cost of abnormal production activities (Abn_Prod)

   The cost of abnormal production activities is profit manipulation which is carried out by manipulating production costs at a higher cost than it should be. The cost of abnormal production activities is formulated as the difference between the actual production costs and the level expected in each year of the company.

$$\text{Prod}_{it}/\text{Assets}_{i,t-1} = c_{1t}(1/\text{Assets}_{i,t-1}) + c_{2t}(\text{Sales}_{i,t}/\text{Assets}_{i,t-1})$$

$$+ c_{3t}(\Delta\text{Sales}_{i,t}/\text{Assets}_{i,t-1}) + c_{4t}(\Delta\text{Sales}_{i,t-1}/\text{Assets}_{i,t-1}) + \lambda_i + e_{it},$$

Where:

Cfop_{it}	=	The company's operating cash flow for the year.
Discexp_{it}	=	Research and development costs plus sales costs plus advertising, administrative and general costs.
Prod_{it}	=	Cost of goods sold plus changes in inventory.
Asset_{it-1}	=	Total assets of the company in the previous year.
Sales_{it}	=	Sales of the company in the year.
Sales_{it-1}	=	Sales of the company in the previous year.
ΔSales_{it}	=	Changes in the company's sales in the year with the previous year.
$\Delta\text{Sales}_{it-1}$	=	Change in the company's sales in the previous year with the previous 2 years.

Independent Variable

The measurement of independent variables are summarized in the following table.

Table 1. Independent Variable Measurement

Variable	Measurement
Audit Quality	If company is audited by KAP Big4 are given a value of 1, and if not audited by Big4 then given a value of 0.
Audit Committee Expertise	The percentage of the audit committee which has expertise in accounting and finance.
Audit Committee Tenure	The percentage of tenure of audit committees that have a term of office for 2 years as an audit committee.
Size of Audit Committee	The number of audit committees.
Audit Committee Meeting	The frequency of audit committee meetings.
Board of Directors	The number of company boards of directors.
Independent Director	The percentage of independent directors.

Source: (Sitanggang et al., 2019) and (SUSANTO & PRADIPTA, 2020).

3.2. Sample

The object of this research is to use financial reports on the Indonesian stock exchange in 2016-2020. This study uses purposive sampling where the method of determining the sample is based on the terms selected based on the benchmarks determined by the researcher(Sitanggang et al., 2019).

3.3. Method of analysis

In testing the data using the SPSS program as the first initial stage to test descriptive statistics and remove outliers. Followed by using Eviews-10 to determine the most suitable model. This study uses the panel regression method to examine and determine whether there is a relationship between the independent variable and the dependent variable. This study uses a combination of cross section and time series.

4. RESULTS AND DISCUSSIONS

Testing the data in this study uses secondary data derived from the financial statements and annual reports of companies listed on the IDX. Data collection uses data from 2016 to 2020. Below is a sample of the data used.

Table 2. List of Number of Companies as Sample

Information	Amount
Companies listed on the IDX in the period 2016 - 2020	741
The company is not complete with its financial statements	338
Company as research sample	403
Research year	5 years
Total data for the period 2016 – 2020	2015
Number of research outlier data	78
Number of non-outlier research data	1937

The information on table 1, shows that there are 741 companies listed on the Indonesia Stock Exchange during a 5-year period, of which 403 complete companies can be used as samples in this study. The total number of data is 2015 data, of which 78 data are outlier data after sorting the data, so there are only 1937 data that can be sampled due to the outlier data.

Table 3. Descriptive Statistics Test Results

	N	Min	Max	mean	Std Deviation
Cfopit	1937	-1.13	4.30	0.6449	.64917
Discexpit	1937	-.50	2.62	.6113	.53780
Prodit	1937	-1.70	4.38	0.6659	.70979
Committee Audit Expertise	1937	0.00%	100.00%	65.1390%	27.90484%
Committee Audit Tenure	1937	0.00%	100.00%	71.0419%	34.47273%
Size of Audit Committee	1937	0	8	3.104	.5892
Committee Audit Meeting	1937	0	77	7.105	6.0928
Board of Directors	1937	2	16	4.930	2.0684
Independent Director	1937	0.00%	75.00%	14.0515%	14.96930%

The table 2 shows the results of the minimum, maximum, average, and also the standard deviation of each variable studied in this study. It can be seen that each of the average values of real earnings management variables with three proxies, namely Cfopit,

Discexpit, and Prodit, shows the numbers 0.6449, 0.6113, and 0.6659. While the resulting standard deviation is higher than the average value except for the Discexpit variable, namely 0.64917, 0.53780, and 0.70979, which shows that the real earnings management variable is stated to have a relatively wide spread of data except for the Discexpit variable.

The average expertise presented shows the figure of 65.14% where expertise in finance and accounting on the audit committee from the data exceeds half of those who have such expertise. The minimum and maximum values for these skills are at 0% and 100%, and also have a standard deviation which shows below the average value of 27.90484%, and also shows that the data are not widely distributed.

The tenure of the audit committee has a minimum value of 0% and a maximum of 100%, which has an average value of 71.0419%, which means that most of those on the audit committee have a tenure of more than 2 years. The standard deviation shows a figure of 34.47273% which indicates the spread of the tenure data is not so wide because it is below the average value.

The average audit committee size in the table shows a figure of 3.104 which is higher than the standard deviation of 0.5892 so that the data is not widely distributed, which has a minimum and maximum value of 0 and 8.

Audit committee meetings with a minimum frequency of 0 and a maximum of 77. Audit committee meetings have an average of 7.105 and the standard deviation shows a number of 6.0928 which is smaller than the average value.

The director in the data collected has an average value of 4.930, with a minimum value of 2 and a maximum of 16. Has a standard deviation of 2.0684 which is smaller than the average value so that the distribution of the data is stated to be narrower.

The independent director has an average value which shows a number of 14.0515% with a minimum and maximum value of 0% and 75%, respectively, which has a standard deviation of 14.96930% which is higher than the average value so that stated to have a wide distribution of data.

Table 4. Dummy Variable Frequency Test Results

Audit Quality	Frequency	Percentage	Valid Percentage	Cumulative Percentage
Non Big Four	1188	61.3	61.3	61.3
Big Four	749	38.7	38.7	100.0
Total	1937	100.0	100.0	

The frequency test value on the audit quality dummy variable shows that out of a total of 403 companies, there are 61 companies that use NonBig4 external auditors while 39 other companies use Big4, with a percentage of 61.3% being Non-Big4 and 38.7% being Big4 of the total.

Outlier test results are a number of data that are declared to be unreasonable and will be eliminated from the research sample. Based on all the data tested, there were 78 data that had values <-1.96 and >1.96. So that after eliminating outlier data there are only 1937 data that can be used as research samples.

The regression panel has a test with models including the PLS, FEM, and REM models which aims to choose the best model among the three models. The selection of the model is based on the results of the Chow test, if the results of the Chow test indicate the direction of the FEM regression results, it will be followed up by carrying out the results of the Housman test to determine the best model.

Table 5. Chow Test Results

Cross-section Effects Tests	Prob.
Chi-square Cfopit	0.0000
Chi-square Discexpit	0.0000
Chi-square Prodit	0.0000

The probability value of the Chow test results for real earnings management data based on the Cfopit, Discexpit, and Prodit measurements is 0.0000. The benchmark value is <0.05 indicating the FEM model that must be applied. The next step is to do the Housman test to prove the best model between FEM and REM.

Table 6. Housman Test Results

Test Summary	Prob.
Cross-section random Cfopit	0.0055
Cross-section random Discexpit	0.0001
Cross-section random Prodit	0.0073

The results of the Housman test are based on probability values such as the numbers shown in the table above, namely 0.0055, 0.0001, and 0.0073 or below 0.05. The best choice of model to use in this test is FEM.

Table 7. F . Test Results

Dependent Variable	Prob.
Cfopit	0.000000
Discexpit	0.000000
Prodit	0.000000

The value of the f test data from the Cfopit, Discexpit, and Prodit measurements both showed values below 0.05. The results of this f test prove that all independent variables, namely, audit quality, expertise, tenure, size of KA, KA meetings, directors, and directors' independence affect real earnings management.

The following describes the probability results of each variable:

Table 8. T . Test Results

Variable	Coefficient	Prob.	Conclusion	Hypothesis
Constant	0.613190	0.0000		
Audit Quality	0.059157	0.2516	Not significant	Rejected
Committee Audit Expertise	-0.161197	0.0174	Negative Significant	Accepted
Committee Audit Tenure	-0.019282	0.5198	Not significant	Rejected
Size of Audit Committee	-0.043054	0.1008	Not significant	Rejected
Committee Audit Meeting	0.002658	0.3558	Not significant	Rejected
Board of Directors	0.030374	0.0134	Significantly Positive	Rejected
Independent Director	0.658381	0.0000	Significantly Positive	Accepted

Cfopit = 0.613190 + 0.059157X1 - 0.161197X2 - 0.019282X3 - 0.043054X4 + 0.002658X5 + 0.030374X6 + 0.658381X7 + E

Table 9. T . Test Results

Variable	Coefficient	Prob.	Conclusion	Hypothesis
Constant	0.709985	0.0000		
Audit Quality	-0.006916	0.7384	Not significant	Rejected
Committee Audit Expertise	-0.003391	0.9007	Not significant	Rejected
Committee Audit Tenure	-0.006048	0.6150	Not significant	Rejected
Size of Audit Committee	-0.015993	0.1289	Not significant	Rejected
Committee Audit Meeting	-0.001274	0.2703	Not significant	Rejected
Board of Directors	-0.006127	0.2135	Not significant	Rejected
Independent Director	-0.004580	0.9017	Not significant	Rejected

Discexpit = 0.709985 - 0.006916X1 - 0.003391X2 - 0.006048X3 - 0.015993X4 - 0.001274X5 - 0.006127X6 - 0.004580X7 + E

Table 10. T . Test Results

Variable	Coefficient	Prob.	Conclusion	Hypothesis
Constant	0.488962	0.0001		
Audit Quality	0.041256	0.4918	Not significant	Rejected
Committee Audit Expertise	-0.093351	0.2359	Not significant	Rejected
Committee Audit Tenure	-0.012669	0.7161	Not significant	Rejected
Size of Audit Committee	-0.020042	0.5111	Not significant	Rejected
Committee Audit Meeting	0.002143	0.5221	Not significant	Rejected
Board of Directors	0.034909	0.0145	Significantly Positive	Rejected
Independent Director	0.751783	0.0000	Significantly Positive	Accepted

Profit = 0.488962 + 0.041256X1 - 0.093351X2 - 0.012669X3 - 0.020042X4 + 0.002143X5 + 0.034909X6 + 0.751783X7 + E

Information :
X1 = Audit Quality
X2 = Committee Audit Expertise
X3 = Committee Audit Tenure
X4 = Size of Committee Audit
X5 = Committee Audit Meeting
X6 = Board of Directors
X7 = Independent Director

Based on the test result, the variable in real earnings management shows a probability value indicating that audit quality, committee audit expertise, committee audit tenure, size of audit committee, committee audit meetings and board of directors does not

have a significant relationship with real earnings management because all the probabilities from the test result that shown is higher than 0.05, and then have or no have an audit committee in the company is doesn't related to their financial report because in Indonesia doesn't matter to make real earnings management possible and it same to the research of Mishra & Malhotra (2016), Lisa & Zadeh (2016), Carmona, et al. (2015), and SUSANTO & PRADIPTA (2020), so H1 to H6 cannot be accepted. Independent directors have a significant positive relationship with real earnings management, so H7 is accepted and it same to the research of Mohammad, et al. (2016) and Taktak & Mbarki (2014).

Table 11. Coefficient of Determination Test Results

Dependent Variable	Adjusted R-Squared
Cfopit	0.719390
Discexpit	0.934112
Prodit	0.682504

Adjusted R-Squared showed a result of 0.719390 for the Cfopit measurement, 0.934112 for the Discexpit measurement, and 0.682504 for the Prodit measurement. Indicating that audit quality, audit committee expertise, audit committee tenure, audit committee size, audit committee meetings, board of directors, and independent directors can explain the dependent variables of 71.9390%, 93.4112% and 68.2504% while 28, 0610%, 6.5888%, and 31.7496% were explained by other variables not included in this study.

5. CONCLUSION

Research on audit quality, audit committee expertise, audit committee tenure, audit committee size, audit committee meetings, board of directors, and independent directors was conducted on companies listed on the IDX and met the criteria containing financial statements and annual reports from 2016 to 2020. The results showed that audit quality, audit committee expertise, audit committee tenure, audit committee size, audit committee meetings and the board of directors had no significant relationship to real earnings management. Meanwhile, the independent director variable itself has a significant positive relationship with real earnings management.

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