



The Influence of Audit Quality and Company Size on Earnings Management moderated by the Audit Committee at Islamic Commercial Banks in Indonesia

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Article Info:

Abstract

Keywords:

Financial Stability;
Ineffective Supervision;
Financial Statement Fraud;
Tax Avoidance;

This study examines The Influence of Audit Quality and Company Size on Earnings Management moderated by the Audit Committee at Islamic Commercial Banks in Indonesia in the 2016 – 2021 period. There are many reasons for management to carry out earnings management, among others due to the conflict of interest that occurs between management as an agent and investors as principals which often benefit one party. Earnings management practices can affect the fairness of the presentation of financial statements, so that financial reports can mislead the user when they are supposed to be useful for the user. The research method used is the saturated sample method which uses secondary data in the form of annual reports of fourteen Islamic commercial banks in Indonesia that provide Annual Reports. The data obtained were processed by multiple linear regression analysis using SPSS statistical tools. The results of this study indicate that Audit Quality has no significant effect on earning management, while the company size has a significant effect on earning management. The existence of audit committee as a moderating variable does not affect the relationship between Audit Quality and company size on earning management. This research is expected to be a reference for further research. This research is expected to be a reference for further research.

Article History:

Received : 20-08-2024
Revised : 28-08-2024
Accepted : 28-08-2024

Article DOI :

<http://dx.doi.org/>

How to cite : Chairunisa, M., & Sarpingah, S. (2024). The Influence of Audit Quality and Company Size on Earnings Management moderated by the Audit Committee at Islamic Commercial Banks in Indonesia. *Economics & Islamic Finance Journal (ECIF)*, 1(2), 87-96. <https://ejournal.bacadulu.net/index.php/ecif/article/view/13>



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INTRODUCTION

Rapid developments in today's business world require companies, especially go public companies, to create a competitive advantage for their companies to obtain external funds to support the company's operations. Profit information derived from financial statements is generally the main focus of investors. This condition will motivate company managers to carry out certain strategies to generate profits that are in accordance with the expectations of investors. This motivation causes financial reports to be misused in various ways such as

leveling, increasing and decreasing profits to affect the value of profits to be reported which is known as earnings management (Purnama, 2017).

Earnings management is a familiar phenomenon in today's accounting world. Earnings management practices can occur due to agency conflicts described in agency theory. Earnings management practices can affect the fairness of the presentation of financial statements, so that financial reports can mislead the user when they are supposed to be useful for the user. Earnings management is not always associated with efforts to manipulate accounting data or information, but with the selection of accounting methods that are deliberately chosen by management.

One of the efforts to monitor earnings management practices is to audit financial reports. Audit is an important contributor to monetary resilience, company re-establishment, and market and consumer confidence (Alabdullah & Ahmed, 2020). Audit quality describes how well the audit detects and reports material misstatements in the financial statements. High audit quality will be in line with the high quality of financial statement information because financial reports audited by high-quality auditors will be less likely to contain material misstatements (Yasser & Soliman, 2018).

Another factor that is thought to influence earnings management is company size. Company size is a comparison used to show the size of the company through total assets, net sales, and market capitalization (Mahawyahrti & Budiasih, 2016). Companies with larger sizes have more assets and more capital invested. This shows that more and more parties are involved in the company. Companies with a larger size tend to be more careful in presenting financial statement conditions because they are under tighter supervision which tends to reduce earnings management actions.

The audit committee as a corporate governance mechanism has the expertise to evaluate management's financial reports. A more experienced audit committee (experts in accounting, finance, business industry and so on) will be more effective in reviewing financial reporting (Sun et al., 2014). Because they have the right knowledge and experience to detect earnings management practices (Suteja et al., 2016). The existence of an audit committee as a good corporate governance mechanism will reduce earnings management practices by agents.

Based on the results of existing research, it can be stated that the conflict in determining the results is still not consistent. This shows a new phenomenon that has developed in several companies and banks. This also encourages researchers to contribute directly in strengthening and overseeing the early detection of earnings management in the banking industry in Indonesia.

The difference between this research and previous research is that this research uses Islamic Commercial Bank objects with an observation period of 2016-2021. Whereas in previous research the year of research used was the year before 2020. Apart from different objects and years, this study also used different variables.

Based on this, the researchers conducted a study entitled "The Influence of Audit Quality and Company Size on Earnings Management moderated by the Audit Committee at Islamic Commercial Banks in Indonesia for the period 2016 - 2021".

LITERATURE REVIEW

According to Jensen & Meckling (1976) Agency theory is the basic thing used to understand the relationship between principals and agents. In this case the agency relationship is a contract between one or more people who employ others to provide a service and then delegate decision making authority to the agent. Based on this theory, there is a separation between the owner (principal) and the manager of the company (agent), causing agency

problems. Furthermore, the separation of owner and manager also creates information asymmetry, which is a condition where agents have access to information that is not owned by the principle. Imbalance of information owned by the owner and manager of the company imposes the emergence of information asymmetry. Based on the assumption of human nature, every human being has a tendency to act by prioritizing his personal interests.

Earnings management is management's choice of accounting policies or concrete actions that affect earnings in order to achieve several profit objectives to be reported (Scott, 2015). This earnings management action is carried out by managers to present profits that are adjusted to the desired goals and are made through the selection of applicable accounting policies (Krisnadewi & Dimarcia, 2016).

Profit is often used as a target for management engineering to minimize and maximize the amount of profit by practicing earnings management (Mardi et al., 2020).

According to Utami (2005) to detect the presence or absence of earnings management, the measurement of accruals is very important to note. Total accruals are the difference between profit and cash flows from operating activities. Total accruals are divided into two parts, namely: (1) the accrual part which is naturally present in the process of preparing financial statements is called normal accruals or non-discretionary accruals, and (2) the accrual part which is manipulation of accounting data is called abnormal accruals or discretionary accruals.

Quality Audit is a systematic process to objectively obtain and evaluate evidence regarding statements about economic activities and events, with the aim of determining the degree of conformity between these statements and predetermined criteria and conveying the results to interested users (Mulyadi, 2016). The quality of the external auditor is an important mechanism for controlling the opportunistic behavior of managers. Audit quality is highly dependent on the competence and independence of the external auditor which may be related to the size of the KAP (Bouchareb, 2014). Audit quality is influenced by the auditor's educational background, audit structure, supervisory ability, and workload (Aji & Hapsari, 2018). Competence, independence, and size of the accounting firm are also the scope of audit quality (Nadia, 2015).

Based on agency theory, there is a conflict between the principal and the agent. The conflict was caused by a conflict of interest between the two parties. The agent, in this case, is the management required to make financial reports as a form of accountability to the principal. On the other hand, the principal wants to know how management is performing in managing the company. The Principal can find out all the information from the financial reports prepared by management. However, what often happens is management's tendency to take actions that make the financial statements look good. Therefore, it is necessary to test the financial statements conducted by an independent party. The independent party is an independent auditor. Financial reports audited by quality auditors will also produce quality information (Fathoni, 2020).

A quality audit is able to reduce earnings management practices. This is because the financial statements audited by the big four KAPs are able to provide better audit quality assurance so as to prevent companies from carrying out earnings management (Fandriani & Tunjung, 2019).

Purnama (2017) stated that the larger the size of the company, the smaller the earnings management actions. This is because large companies are increasingly increasing the attention of investors so as to put pressure on reliable financial reporting. Shu & Chiang (2014) stated that large companies receive more attention from investors, thus requiring companies to always report good profits. Shu & Chiang (2014) stated that company size has a negative relationship with earnings management. Large companies have a tendency to manage

earnings that are smaller than small companies. This is because large companies are seen as more critical by shareholders and outsiders so that large companies get stronger pressure to present accurate financial reports. Investors in investing usually choose companies that are able to show good performance so that the invested capital will later obtain profitable results.

The audit committee is a committee that takes a strategic and important role in the company to maintain the credibility of the preparation of financial reports so that the internal control system can run well (Giovani, 2017). The audit committee needs to have competence and expertise in accounting and finance (Wulandari & Fitria, 2019). Article 1 point 5 of the Financial Services Authority Regulation Number 1/POJK.03/2019 of 2019 concerning the Implementation of the Internal Audit Function in Commercial Banks ("POJK 1/2019"), explains that the Audit Committee is a committee established by and responsible to the Board of Commissioners in assisting in carrying out the duties and functions of the Board of Commissioners. Financial Services Authority Regulation Number 55/POJK.04/2015 concerning the Establishment and Guidelines for Implementation of Audit Committees in Article 7, must have at least 1 (one) member with an educational background. and expertise in accounting and finance.

The existence of an audit committee has a negative relationship to earnings management. Meanwhile, research on the influence of audit committees on audit quality shows that audit committees have a negative effect on audit quality (Khurnanto & Syafruddin, 2015). Destania & Puspitasari's research (2021), the Audit Committee has a positive and significant effect on the amount of fraud that occurs in Islamic Commercial Banks in Indonesia. This shows that the large number of audit committee members does not reduce the amount of fraud that occurs.

Based on a review of the theory and previous studies, the hypotheses proposed in this study are as follows:

- H1 = Audit Quality affects Earnings Management
- H2 = Company size has an effect on Earnings Management
- H3 = Audit Quality affects Earnings Management moderated by the Audit Committee
- H3 = Company size affects Earnings Management moderated by the Audit Committee

METHOD

The data used in this study are secondary data obtained from the 2016-2021 Indonesia Stock Exchange. The total sample used in this study is 66 Financial Statements and GCG Reports of Sharia Banks.

RESULTS AND DISCUSSION

Descriptive Statistics Test Results

The output of the Descriptive Statistics display shows the number of respondents (N) as many as 60. Profit Management is a minimum of -8.7 and a maximum of 8.3, where the average is -0.77. Minimum Audit Quality is 0 and maximum is 1, where the average is 0.48. The minimum company size is 27.2 and the maximum is 33.2, where the average is 30,438.

Table 1
 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Manajemen Laba	60	-8.7	8.3	-.077	2.3705
Kualitas Audit	60	0	1	.48	.504
Ukuran Perusahaan	60	27.2	33.2	30.438	1.4270
Valid N (listwise)	60				

Source : SPSS Data 2023

Classic assumption test

The DW value of 2.048 will be compared with the Durbin – Watson table value. The number of samples (N) is 60 and the number of independent variables is 2 (k = 2), so the values for DL = 1.5144 and DU = 1.6518 are obtained. Because the DW value of 2.048 is greater than the upper limit (DU) of 1.6518 and less than 4–DU, namely 4 – 1.6518 = 2.3482, so the results obtained are 1.6518 < 2.048 < 2.3482 and are in accordance with the conditions $DU < DW < 4 - DU$, it can be concluded that in this regression model there is no autocorrelation.

Table 2
 Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.363 ^a	.132	.100	1.7182	2.048

a. Predictors: (Constant), Ukuran Perusahaan, Kualitas Audit

b. Dependent Variable: Manajemen Laba

Model Feasibility Test Reports I

Table 3
 Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.363 ^a	.132	.100	1.7182

a. Predictors: (Constant), Ukuran Perusahaan, Kualitas Audit

b. Dependent Variable: Manajemen Laba

Adjusted R Square (R²) value in table 5.6 is 0.132 or 13.2%. This shows that the variation in Earnings Management of 13.2% is influenced by the variables of Audit Quality and Company Size. While the remaining 86.8% is influenced by other factors outside the research model.

Table 4
ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	24.628	2	12.314	4.171	.021 ^b
	Residual	162.368	55	2.952		
	Total	186.996	57			

a. Dependent Variable: Manajemen Laba

b. Predictors: (Constant), Ukuran Perusahaan, Kualitas Audit

Based on table 4, it can be seen that the results of the ANOVA test or F test in model 1 can be seen from the calculated F value of 6.346 with a probability of 0.021 < 0.05, it can be concluded that the regression model of the financial stability variables and the ineffectiveness of supervision together have a significant effect on earnings management.

Hypothesis Test

Table 5
Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
		(Constant)	15.391	5.373		
1	Kualitas Audit	.154	.464	.043	.331	.742
	Ukuran Perusahaan	-.509	.177	-.370	-2.869	.006

a. Dependent Variable: Manajemen Laba

Based on table 5 above, it can be concluded that:

- The significance value of Audit Quality on Earnings Management is 0.742 or more than 0.05. From this significance value it can be concluded that the H1 hypothesis is rejected and the Audit Quality variable has no effect on earnings management.
- The significance value of Company Size to Earnings Management is 0.006 or less than 0.05. From this significance value it can be concluded that the H2 hypothesis is accepted and the firm size variable has a significant and negative effect on earnings management

Regression Analysis with Moderated Regression Analysis (MRA)

Table 6
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.367 ^a	.135	.052	1.7637

a. Predictors: (Constant), M_X2*Z, Ukuran Perusahaan, Kualitas Audit, M_X1*Z, Komite Audit

Table 6
Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	13.733	14.333		.958	.342
Kualitas Audit	.235	1.075	.065	.218	.828
Ukuran Perusahaan	-.466	.456	-.340	-1.024	.311
Komite Audit	1.439	9.738	.376	.148	.883
M_KUA*KA	-.132	.902	-.062	-.146	.884
M_UP*KA	-.035	.311	-.304	-.114	.910

a. Dependent Variable: Manajemen Laba

Interpretation

a. Equation Models

Based on table 6 it is known that the equation model is as follows:

$$Y = 13.733 + 0.235KUA + 0,466UP + 1.439PP - 0.132KUA*KA - 0.35UP*KA + e \quad (1)$$

b. Coefficient of Determination

Adjusted R Square (R²) value of 0.135 means that 13.5% of the dependent variable of earnings management can be explained by the independent variables of audit quality, company size and audit committee. The remaining 86.5% is influenced by other variables outside the model.

c. Conclusion

1. Moderate variable significance (KUA*KA) 0.884 < 0.05. These results show that the audit committee as a moderating variable between audit quality has no sensitivity to earnings management or in other words the audit committee as a moderating variable has no effect or weakens the effect on audit quality and earnings management.
2. Moderate variable significance (UP*KA) 0.910 > 0.05. These results show that the audit committee as a moderating variable between firm size has no sensitivity to earnings management or in other words the audit committee as a moderating variable has no effect on firm size and earnings management or weakens the effect on audit quality and earnings management.
3. The value of Adjusted Square (R²) in the first regression was 0.132 or 13.2%, whereas after the second equation the value of R² did not increase significantly to 0.135 or 13.5%.

CONCLUSION

Based on the results of the research and discussion used according to the purpose of the hypothesis, which was carried out by MRA analysis in equation 1 before there was a moderating variable and MRA analysis in equation 2 after there was a moderating variable, the following conclusions can be drawn:

1. Audit quality is proven to have no effect on earnings management. This means that large KAPs do not limit earnings management behavior but increase the possibility of earnings management. Because audit quality is used solely to attract investors to be interested in investing. The longer the auditor audits in financial institutions, the

- greater the client's familiarity, and can reduce the auditor's independence in auditing the company.
2. Company size has a significant and negative effect on earnings management. This indicates that the larger the company will tend not to show earnings management practices because large companies receive more political attention from government institutions compared to small companies. The greater the assets owned by the company, the greater the invested capital and also the greater the sales so that the velocity of money is large, as well as the market capitalization. This condition will make the company more widely known to the public so that the company must be able to meet the expectations expected by investors.
 3. Based on the MRA test, it can be concluded that the audit committee is not capable of being a moderating variable because the audit committee weakens the relationship between audit quality and company size to management. This illustrates that the existence of an audit committee is not able to reduce the occurrence of earnings management despite the size of the large company and the quality of the audits conducted by large KAPs.

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